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Investor protection and the civil liability for defective disclosures in the Saudi securities market: a legal analysis

Badar Mohammad G Almeajel Alanazi

University of Wollongong
UNIVERSITY OF WOLLONGONG

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INVESTOR PROTECTION AND THE CIVIL LIABILITY FOR DEFECTIVE DISCLOSURES IN THE SAUDI SECURITIES MARKET: A LEGAL ANALYSIS

A Thesis Submitted in Fulfilment of the Requirements for the Award of the Degree of

DOCTOR OF PHILOSOPHY

from

UNIVERSITY OF WOLLONGONG

By

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December 2012
SUMMARY OF CONTENTS

STATEMENT OF AUTHORSHIP................................. ii

ABSTRACT....................................................... iii

ACKNOWLEDGMENTS........................................... v

AUTHOR’S PUBLICATIONS..................................... vii

TABLE of CONTENTS........................................... viii

LIST of FIGURES and TABLES............................... xvi

LIST of ABBREVIATIONS...................................... xviii

CHAPTERS 1-10.................................................. 1

BIBLIOGRAPHY.................................................. 450
STATEMENT OF AUTHORSHIP

I, Badar M Alanazi, declare that this thesis, submitted in fulfilment of the requirements for the award of Doctor of Philosophy, in the Faculty of Law, University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualifications at any other academic institution.

Badar Mohammad G Almeajel Alanazi

December 2012
ABSTRACT

The Saudi securities market has been suffering from the lack of transparency and disclosure credibility, which accounts for the market collapse in 2006 causing a loss of 50 per cent of the total market value and heavy losses for many investors. This disaster has triggered an effect on a large proportion of the population, and in several cases, death was recorded, and there were other instances where people became ill due to the stress of the situation. However, such investors have not yet been compensated. One main reason for this bad state of the market is the non-compliance with corporate disclosures requirements set out by the Capital Market Law 2003 (Saudi Arabia) (CML’03) and the regulations issued by the Capital Market Authority (CMA). This collapse was caused by widespread defective corporate disclosures.

The aim of this thesis is to examine the civil liability regime for defective disclosures in the Saudi securities market from the perspective of investor protection. An analytical approach to the examination of the relevant legal rules and principles has been adopted in undertaking the present thesis. The civil liability regime attracted by breaches of the disclosure rules related to prospectus and post-prospectus disclosures (continuous and periodic disclosures) has been examined. In this connection, to assess whether the Saudi investors have sufficient protection, the relevant laws and principles from selected developed countries (the United States (US), the United Kingdom (UK), Australia and Canada), and the principles of securities market regulation set out by the International Organisation of Securities Commissions (IOSCO) and case laws have been discussed as a benchmark.
This thesis also examines the remedy provisions for investors, defences available to the accused (such as the issuers), and the judicial and administrative enforcement of these provisions (including those related to the disclosure regime) of the Saudi securities laws compared to the laws of the above mentioned jurisdictions. Finally, this study arrives at the finding that Saudi Arabia lacks a strong disclosure, liability and remedy regime in terms of both substantive provisions and their enforcement through the court of law and the securities commission. There follows a number of suggestions to bring about legal and regulatory reforms in the securities law of Saudi Arabia with particular reference to the areas of concern under scrutiny in this study.
ACKNOWLEDGEMENTS

In spite of difficulties, obstacles and barriers that I have confronted on my PhD journey, I am so excited to recognise people who have contributed to making this PhD thesis complete. In fact, this PhD thesis would not have been achieved without their help, support and good wishes.

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My sincere thanks and appreciation go to my father, Mohammad who provides me with endless support and hope from the time I started my Bachelor degree right up until the present moment. It has been his dream even more than mine for me to complete the PhD study and obtain this qualification. Equally, I wish to offer my genuine thanks to my mother for her prayers and blessings for my success and surmounting difficulties in the study.
Immeasurable appreciation goes to my wife, Ghadir, for her love and sacrifices, and to our children, Lateen and Nawaf, who always inspire me and give me hope to carry on.

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AUTHOR’S PUBLICATIONS

Parts of this thesis were originally published and presented in:


TABLE OF CONTENTS

SUMMARY OF CONTENTS .................................................................................... i

STATEMENT OF AUTHORSHIP .......................................................................... ii

ABSTRACT ............................................................................................................... iii

ACKNOWLEDGEMENTS ....................................................................................... v

AUTHOR’S PUBLICATIONS ............................................................................... vii

TABLE OF CONTENTS ........................................................................................ viii

LIST OF FIGURES ................................................................................................ xvi

LIST OF TABLES ................................................................................................. xvii

LIST OF ABBREVIATIONS .................................................................................... xviii

1  General Introduction ......................................................................................... 1
   1.1 Introduction ................................................................................................ 1
   1.2 Statement of Problem ................................................................................... 4
      1.2.1 Lack of Regulation ............................................................................... 4
      1.2.2 Inadequate Protection of Investors ................................................... 7
   1.3 Significance and Benefits of the Study ......................................................... 9
   1.4 Aims and Objectives of the Study .............................................................. 12
   1.5 Scope and Limitation of the Study ............................................................. 13
   1.6 Research Questions and Sub-Questions ..................................................... 15
   1.7 Research Methodology and Data Collection.............................................. 16
   1.8 Summary and Conclusions ......................................................................... 21

2  Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts. ................................................................................................................... 23
   2.1 Introduction ................................................................................................ 23
   2.2 Background to Saudi Arabia ...................................................................... 24
      2.2.1 Saudi Arabia and Its Legal System ................................................... 26
   2.3 Introduction to the Securities Market .......................................................... 31
      2.3.1 The Role and Function of Securities Markets ........................................ 32
      2.3.2 The Importance of the Securities Market in Saudi Arabia ................... 34
   2.4 The Development of the Securities Market in Saudi Arabia ...................... 35
      2.4.1 The Inception and Development of the Saudi Securities Market 1935–1984.................................................................................................................. 36
2.4.2 Growth and Development of the Saudi Securities Market 1985–2002 ........................................ 40
2.4.3 Saudi Securities Market Development 2003–2011 ............................................................... 46
2.4.4 Comparative Position of the Saudi Securities Market amongst Its Regional and International Counterparts ...................................................................................... 55
2.5 General Drawbacks of the Development of the Saudi Securities Market .................................. 59
2.5.1 The Small Number of Listed companies.................................................................................. 61
2.5.2 Instability of the Market........................................................................................................... 63
2.5.3 The Absence of Foreign Portfolio Investment ....................................................................... 65
2.6 The Reasons for Weak Investor Protection and its Effects on the Development of the Saudi Securities Market ........................................................................................................ 67
2.6.1 Lack of Transparency and Disclosure .................................................................................... 67
2.6.2 Weak Civil Liability for Defective Disclosures and the Development of the Securities Market in Saudi Arabia .......................................................................................... 69
2.7 The Meaning of Concepts and Terms ........................................................................................ 71
2.7.1 Securities .............................................................................................................................. 71
2.7.2 Securities Regulation ............................................................................................................. 73
2.7.3 Investors .............................................................................................................................. 75
2.8 Investor Protection and the Development of the Securities Market .......................................... 76
2.8.1 The Importance of Disclosure in Relation to the Investor Protection.................................... 77
2.8.2 Disclosure Methods of Protecting Investors in the IPO Market ........................................... 80
2.8.3 The Meaning of the Disclosure Regime in this Study ................................................................ 81
2.8.4 The Concept of Civil Liability ............................................................................................... 81
2.9 Summary and Conclusions ...................................................................................................... 84
3 Legal and Regulatory Frameworks of the Securities Market in Saudi Arabia ........................................... 88
3.1 Introduction ................................................................................................................................ 88
3.2 Historical Overview of the Legal and Regulatory Frameworks of the Securities Market in Saudi Arabia ................................................................................................................. 88
3.2.1 The Former Legal Framework of the Securities Market .................................................... 88
3.2.2 The Former Regulatory Framework of the Securities Market ............................................. 92
3.3 The Current Legal Framework of the Securities Market in Saudi Arabia ................................... 96
3.3.1 The Major Saudi Securities Laws ......................................................................................... 97
3.3.2 Laws Governing Persons Involved in the Disclosure Regime ............................................. 99
3.4 The Existing Regulatory Framework ................................................................. 100
  3.4.1 Composition of the Capital Market Authority ......................................... 101
  3.4.2 Powers of the Board of the Capital Market Authority (BCMA) ............ 102
  3.4.3 Powers and Functions of the Capital Market Authority ......................... 103
  3.4.4 The Saudi Stock Exchange ..................................................................... 106
3.5 The Regulatory Role of the CMA in Regard to Disclosures ....................... 109
  3.5.1 The Current Disclosure Regulatory Framework .................................... 109
3.6 Summary and Conclusions ............................................................................. 112

4 Civil Liability for Defective Disclosures in a Prospectus under Saudi
  Securities Laws ..................................................................................................... 115
  4.1 Introduction ..................................................................................................... 115
  4.2 Disclosure Requirements for a Prospectus .................................................. 118
    4.2.1 Prospectus Requirements under Saudi Laws ........................................ 119
    4.2.2 Prospectus Requirements under Developed Countries’ Laws .......... 121
    4.2.3 Evaluation of the Prospectus Requirements under Saudi Laws ........ 126
  4.3 Objectives of Prospectus Civil Liability ...................................................... 134
  4.4 Defectiveness of Prospectuses in Saudi Securities Law ............................... 135
    4.4.1 Meaning and Scope of Term ‘Defective Prospectus’ in Relation to
      Saudi Securities Law ....................................................................................... 135
    4.4.2 The Materiality Requirement ............................................................... 138
  4.5 Civil Liability for a Defective Disclosure in a Prospectus ........................... 141
    4.5.1 Civil Liability Provisions Dealing with Prospectus Liability in Saudi
      Arabia............................................................................................................. 141
    4.5.2 Civil Liability for Defective Disclosures in a Prospectus under the
      Laws of Selected Developed Countries ......................................................... 145
  4.6 Evaluation of Civil Liability Provisions for a Defective Prospectus in Saudi
      Arabia ............................................................................................................. 148
    4.6.1 Drawbacks of the Civil Liability Provisions ......................................... 148
    4.6.2 Functions of Promoters and the Rationale for their Civil Liability for a
      Prospectus ..................................................................................................... 151
    4.6.3 Functions of Lawyers and the Rationale for their Civil Liability for a
      Prospectus ..................................................................................................... 154
4.6.4 Functions of Issue Managers and the Rationale for their Civil Liability for Prospectus ................................................................................................... 156
4.7 Considering Arguments against the Extension of Civil Liability to Every Person Who Participated in the Preparation of a Prospectus ....................... 159
4.8 Summary and Conclusions ....................................................................... 162

5 Civil Liability for Defective Disclosures in the Secondary Market under Saudi Securities Laws: Continuous Disclosure and Periodic Disclosure .......... 164
5.1 Introduction .............................................................................................. 164
5.2 The Objectives of Disclosure in the Secondary Market ....................... 166
5.2.1 The Importance of Disclosure in the Saudi Secondary Securities Market ............................................................................................................. 167
5.3 Continuous Disclosure Requirements in the Secondary Market ............ 169
5.3.1 The Scope of Continuous Disclosure ................................................... 169
5.3.2 Requirements for Continuous Disclosure ............................................ 173
5.4 Periodic Disclosure Requirements in the Secondary Market ............... 181
5.4.1 Scope and Meaning of Periodic Disclosures ....................................... 181
5.4.2 Periodic Disclosure Requirements under Securities Laws in Selected Developed Countries ........................................................................................ 182
5.4.3 Periodic Disclosure Requirements under Securities Laws in Saudi Arabia ............................................................................................................. 183
5.5 The Objective of Civil Liability for Defective Disclosure in the Secondary Market ................................................................................................................. 190
5.6 Provisions Dealing with Civil Liability for Defective Disclosures in the Secondary Market under the Saudi Securities Laws ........................................ 191
5.7 Civil Liability Provisions and Their Applicability to the Defective Continuous Disclosure ........................................................................................................... 194
5.7.1 Civil Liability for Continuous Disclosure in Saudi Arabia ............... 194
5.7.2 Civil Liability for Defective Continuous Disclosure in Developed Countries ................................................................................................................. 196
5.7.3 The Imposition of Civil Liability Provisions for Defective Continuous Disclosure in Saudi Arabia ................................................................. 198
5.8 Civil Liability Provisions and Their Applicability to Defective Periodic Disclosures ........................................................................................................... 203
5.8.1 Civil Liability Provisions for a Breach of Periodic Disclosure Requirements in Saudi Arabia ................................................................. 203
5.8.2 Civil Liability for Defective Periodic Disclosures under the Legislation of Developed Countries ................................................................. 204
5.8.3 The Imposition of the Civil Liabilities for Defective Periodic Disclosures in Saudi Arabia ................................................................. 207
5.9 Summary and Conclusions ........................................................................ 210
6 Investors’ Remedies against the Breaches of the Disclosure Regime under Saudi Securities Laws ................................................................. 214
6.1 Introduction .................................................................................................... 214
6.2 The Objective of Private Enforcement of the Civil Liability for Breaches of Disclosure Regime ................................................................. 215
6.3 Investor Remedies for Violations of the Disclosure Regime .................. 218
   6.3.1 Introduction to Remedies .................................................................. 218
   6.3.2 Overview of the Remedies Available under the Selected Developed Jurisdictions ........................................................................... 219
6.4 Remedies Available under the Saudi Securities Laws .......................... 222
   6.4.1 Causes of Action to Claim Civil Remedies for Defective Disclosures under Saudi Securities Laws ................................................................. 222
   6.4.2 Remedies for Breaches of Prospectus Requirements ..................... 224
   6.4.3 Remedies for Breaches of Disclosure Requirements in the Secondary Market .......................................................................................... 225
6.5 The Drawbacks of Remedies Available under the Saudi Securities Laws ........................ ................................................................. 227
   6.5.1 Weaknesses in Regard to the Remedy of Damages ...................... 228
   6.5.2 The Significance of Equitable Remedies as an Alternative to Damages ................................................................................................. 232
   6.5.3 The Absence of the Remedy of Rescission ...................................... 233
6.6 Persons Who are Entitled to Sue under the Civil Liability Provisions in Saudi Arabia ................................................................. 236
   6.6.1 The Claim of Civil Liability ............................................................... 236
   6.6.2 The Absence of the Securities Class Action Lawsuit .................... 240
   6.6.3 Statute of Limitations ....................................................................... 243
6. 7 Summary and Conclusions ................................................................................................ 247

7 Evidence and Defences with Regard to Civil Liability for Defective
Disclosures under Saudi Securities Laws ................................................................. 250

7. 1 Introduction .............................................................................................................. 250

7. 2 Evidence under the Securities Laws in Saudi Arabia ........................................... 252

7.2.1 Provisions Regarding Evidence in Dealing with Contraventions of the
Securities Disclosure Requirements in Saudi Arabia ........................................... 252

7.2.2 Arguments for the Importance of a Law of Evidence in Saudi Securities
Laws ......................................................................................................................... 253

7.2.3 The Burden of Proof ......................................................................................... 255

7. 3 Defences to Civil Liability for Defective Prospectuses in Saudi Arabia ........ 259

7.3.1 An Overview of Defences against Civil Liability for Defective
Prospectuses in Developed Countries .................................................................... 259

7.3.2 Defences Available under the Saudi Laws ..................................................... 261

7. 4 Due Diligence as a Defence under the Saudi Securities Law ....................... 265

7.4.1 Due Diligence Defence and the Persons Involved in the
Prospectus ............................................................................................................... 266

7.4.2 The Drawbacks in the Due Diligence Defence for Civil Liability under
the Capital Market Law 2003 ................................................................................. 268

7. 5 Defences to Liability for Defective Disclosure in the Secondary
Market .................................................................................................................... 275

7.5.1 Lack of Causation as a Defence for Secondary Market Liability ............. 275

7.5.2 Lack of Authorisation Defence ...................................................................... 279

7. 6 Summary and Conclusions ................................................................................. 281

8 Judicial Enforcement of the Securities Laws against Violations of the
Disclosure Requirements in the Saudi Securities Market ................................ 285

8. 1 Introduction ........................................................................................................... 285

8. 2 Objectives of the Judicial Enforcement of the Securities Laws .................... 288

8. 3 The Judicial Institutions for Securities Litigation ............................................. 291

8.3.1 Composition of the Courts Dealing with Securities Litigations ............... 292

8.3.2 Members of the CRSD and ACRSC .............................................................. 297

8. 4 Evaluation of the Judiciary for the Adjudication of Securities Litigations in
Saudi Arabia .......................................................................................................... 298
8.4.1 Insufficient Number of Courts Dealing with Securities Cases .......... 299
8.4.2 Shortcomings in the Judicial Independence of the Securities Courts .. 303
8.4.3 Need for Efficient Judges in the Securities Courts ......................... 307
8.4.4 Lack of Lawyers Skilled in Dealing with Securities Litigation ........... 312
8.5 Evaluation of the Current Performance of the Securities Courts in Saudi Arabia .................................................................................................................. 316
8.6 Suits Brought by the Securities Regulators on Behalf of Investors ......... 320
8.6.1 An Outline of the Current Securities Court’s Remedial Powers Provisions .................................................................................................................. 322
8.6.2 General Weaknesses Concerning the Remedial Courts Powers ........ 331
8.7 Summary and Conclusions .................................................................. 335

9 The Securities Regulator’s Role in Enforcing the Disclosure Regime in Saudi Arabia .................................................................................................................. 339
9.1 Introduction ........................................................................................ 339
9.2 Present Administration of the Disclosure Regime in Saudi Arabia ...... 341
9.2.1 Regulatory Enforcement Tools ..................................................... 342
9.2.2 Some Relevant Recent Publicly Reported CMA Administrative Actions .................................................................................................................. 344
9.2.3 Present Enforcement Machinery ................................................ 346
9.3 Existing Drawbacks of the Current Administrative Enforcement Machinery .................................................................................................................. 349
9.3.1 Lack of Transparency .................................................................... 349
9.3.2 Inadequacy of Monetary Fines ...................................................... 351
9.3.3 Weak Intervention ......................................................................... 353
9.3.4 Lack of Uniformity in the Exercise of the Regulator’s Powers ........ 355
9.4 Drawbacks of the Current Securities Regulatory Body in Regard to the Disclosure Regime in Saudi Arabia ................................................................. 359
9.4.1 Insufficiency in the Regulatory Role of the CMA in Regard to Information Intermediation ................................................................. 359
9.4.2 Inefficient Regulatory Role of the CMA in Regard to Self-Regulatory Power ................................................................................................. 368
9.4.3 Need for Reforms in the Regulatory Role of the CMA in Regard to the Disclosure Regime ......................................................................................... 371
**LIST OF FIGURES**

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>Numbers of Saudi Listed Companies (2001–2012)</td>
<td>2</td>
</tr>
<tr>
<td>2.2</td>
<td>Map of Saudi Arabia</td>
<td>25</td>
</tr>
<tr>
<td>2.3</td>
<td>The Judicial System in Saudi Arabia</td>
<td>29</td>
</tr>
<tr>
<td>2.4</td>
<td>Saudi Stock Market Crash and the Fall of the Share Index (TASI) in 2006</td>
<td>53</td>
</tr>
<tr>
<td>3.5</td>
<td>The Old Saudi Regulatory Framework</td>
<td>96</td>
</tr>
<tr>
<td>3.6</td>
<td>Composition of the Capital Market Authority in Saudi Arabia</td>
<td>102</td>
</tr>
<tr>
<td>3.7</td>
<td>Structure of the Present Regulatory Framework of the Securities Market in Saudi Arabia</td>
<td>108</td>
</tr>
<tr>
<td>8.8</td>
<td>Number of Cases Filed with the CRSD and Finalised in the Year they were Lodged</td>
<td>317</td>
</tr>
</tbody>
</table>
LIST OF TABLES

Table 2.1: Saudi Stock Market Indicators 1985-2002 ........................................ 45
Table 2.2: Market Capitalisation and Market Size of the Saudi Stock Market for the Period 1985–2002 .......................................................... 46
Table 2.3: Saudi Stock Market Indicators 2003–2011 ...................................... 51
Table 3.4: Market Capitalisation and Market Size of the Saudi Stock Market 2003–2011 .......................................................... 52
Table 2.5: GCC and Arab Stock Markets Indicators at the End of 2010 ........... 57
Table 2.6: Companies by Type of Capital in Saudi Arabia 2010 ................. 62
Table 3.7: Parties Subject to CMA Supervision ............................................ 108
Table 6.8: Numbers of Cases Filed with the CRSD in 2009, 2010 and 2011 by Type of Case .......................................................... 239
Table 9.9: Grievances against Decisions and Orders of the CMA in 2009 and 2010 (There were 210 Decisions issued by CMA during 2009 and 2010) . 414
# LIST OF ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAT</td>
<td>Administrative Appeals Tribunal (Australia)</td>
</tr>
<tr>
<td>ACRSC</td>
<td>Appeal Committee for the Resolution of Securities Conflicts (Saudi Arabia)</td>
</tr>
<tr>
<td>AMF</td>
<td>Arab Monetary Fund</td>
</tr>
<tr>
<td>APSCO</td>
<td>Arab Petroleum Services Company (Saudi Arabia)</td>
</tr>
<tr>
<td>art/arts</td>
<td>Article/Articles</td>
</tr>
<tr>
<td>ASX</td>
<td>Australian Securities Exchange</td>
</tr>
<tr>
<td>ASIC</td>
<td>Australian Securities and Investments Commission</td>
</tr>
<tr>
<td>BLG’92</td>
<td>Basic Law of Governance 1992 (Saudi Arabia)</td>
</tr>
<tr>
<td>BCMA</td>
<td>Board of the Capital Market Authority (Saudi Arabia)</td>
</tr>
<tr>
<td>CSA</td>
<td>Canadian Securities Administrators</td>
</tr>
<tr>
<td>CMA</td>
<td>Capital Market Authority (Saudi Arabia)</td>
</tr>
<tr>
<td>CML’03</td>
<td>Capital Market Law 2003 (Saudi Arabia)</td>
</tr>
<tr>
<td>cl/cl</td>
<td>Clause/Clauses</td>
</tr>
<tr>
<td>CRSD</td>
<td>Committee for the Resolution of Securities Disputes (Saudi Arabia)</td>
</tr>
<tr>
<td>CL’65</td>
<td>Companies Law 1965 (Saudi Arabia)</td>
</tr>
<tr>
<td>CA’06</td>
<td>Companies Act 2006 (United Kingdom)</td>
</tr>
<tr>
<td>CLP’01</td>
<td>Code of Law Practice 2001 (Saudi Arabia)</td>
</tr>
<tr>
<td>CGR’06</td>
<td>Corporate Governance Regulations 2006 (Saudi Arabia)</td>
</tr>
<tr>
<td>CA’01</td>
<td>Corporation Act 2001 (Australia)</td>
</tr>
<tr>
<td>CRAs</td>
<td>Credit Rating Agencies</td>
</tr>
<tr>
<td>DTR’06</td>
<td>Disclosure and Transparency Rules 2006 (United Kingdom)</td>
</tr>
<tr>
<td>DBR</td>
<td>Disclosure-Based Regulation</td>
</tr>
<tr>
<td>DDC</td>
<td>Due Diligence Committee</td>
</tr>
<tr>
<td>EMH</td>
<td>Efficient Market Hypothesis</td>
</tr>
<tr>
<td>ESIS</td>
<td>Electronic Securities and Information System (Saudi Arabia)</td>
</tr>
<tr>
<td>EMDB</td>
<td>Emerging Markets Data Base</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>ETF</td>
<td>Exchange-Traded Fund (Saudi Arabia)</td>
</tr>
<tr>
<td>FSMA’00</td>
<td>Financial Services and Markets Act 2000 (United Kingdom)</td>
</tr>
<tr>
<td>FSA</td>
<td>Financial Service Authority (United Kingdom)</td>
</tr>
</tbody>
</table>
FTSE  Financial Times Stock Exchange (United Kingdom)
GDP  Government Development Bonds (GDBs) (Saudi Arabia)
GCC  Gulf Cooperation Council Gross Domestic Product
IPOs  Initial Public Offerings
ITC  Integrated Telecom Company (Saudi Arabia)
IOSCO  International Organisation of Securities Commissions
IAA’40  Investment Advisers Act 1940 (United States)
IIROC  Investment Industry Regulatory Organisation of Canada
LJ’07  Law of Judiciary 2007 (Saudi Arabia)
LPSC’00  Law of Procedure before Shari’ah Courts 2000 (Saudi Arabia)
LR’04  Listing Rules 2004  (Saudi Arabia)
MCR’04  Market Conduct Regulations 2004 (Saudi Arabia)
MAR’07  Merger and Acquisition Regulations of 2007 (Saudi Arabia)
MMBES  Market Model Based Event Study (United States)
MBR  Merit-Based Regulation
MoC  Ministry of Commerce (Saudi Arabia)
MoFNE  Ministry of Finance and National Economy (Saudi Arabia)
MENA  Middle East and North Africa
NI 51-102  National Instrument 51-102 Continuous Disclosure Obligations
NRSROs  Nationally Recognised Statistical Ratings Organisations (Canada)
NCB  National Commercial Bank
NRSROs  Nationally Recognised Statistical Ratings Organisations
NYSE Manual  New York Stock Exchange Manual (United States)
OPSR  Objectives and Principles of Securities Regulation
OSA’90  Ontario Securities Act 1990 (Canada)
OSC  Ontario Securities Commission (Canada)
OIC  Organisation of the Islamic Conference
OPEC  Organisation of Petroleum Exporting Countries
RIS  Recognised Information Service (Saudi Arabia)
RPRSD’11  Regulating Procedures for Resolution of Securities Disputes 2011 (Saudi Arabia)
SOX’02  Sarbanes-Oxley Act 2002 (United States)
SSE  Saudi Stock Exchange

xix
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAM(A)</td>
<td>Saudi Arabian Monetary Agency</td>
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<tr>
<td>SSRC</td>
<td>Saudi Share Registration Company</td>
</tr>
<tr>
<td>SAIF</td>
<td>Saudi Arabian Investment Fund</td>
</tr>
<tr>
<td>SOCPA</td>
<td>Saudi Organisation for Certified Public Accountants</td>
</tr>
<tr>
<td>SAR</td>
<td>Saudi Arabian Riyals</td>
</tr>
<tr>
<td>SCMC</td>
<td>Saudi Capital Market Company (Saudi Arabia)</td>
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<tr>
<td>s/ss, §/§§</td>
<td>Section/Sections (the former: UK, Australia, Canada; the latter Germany and the United States)</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission (United States)</td>
</tr>
<tr>
<td>SA’33</td>
<td>Securities Act 1933 (United States)</td>
</tr>
<tr>
<td>SEA’34</td>
<td>Securities Exchange Act 1934 (United States)</td>
</tr>
<tr>
<td>SRO</td>
<td>Self Regulatory Organisation</td>
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<td>Tadawul All Share Index (Saudi Arabia)</td>
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CHAPTER 1: GENERAL INTRODUCTION

1.1 Introduction

Investment is a driving force for any economy. In the age of the market economy, all countries chiefly establish their stock markets for the purpose of accessing people’s savings to finance business and investment activities at a lower cost and with fewer financial risks compared to traditional bank financing. This is supported by academic research that there is a positive correlation between stock market activities and stronger economic growth.¹ This is especially true for emerging markets.²

However, securities markets cannot prosper without effective regulation being in place. Black asserts that regulation is essential for the creation of a strong securities market which can consequently facilitate economic growth.³ La Porta, Lopez-De-Silanes and Shleifer find that the growth of stock markets is strongly linked to extensive disclosure requirements, liability standards and effective enforcement being in place.⁴ Hence, investors feel protected through corporate laws that can remedy their loss or damage resulting from the violation of the securities laws. Over the past few decades, the Kingdom of Saudi Arabia (Saudi Arabia)⁵ has become an attractive place for domestic

² A recent study of 80 developing countries from the period 1973 to 2002 found that the stock market has a significant and positive impact on the economic growth of these developing countries. See Md Rabiu, 'Banks, Stock Markets and Economic Growth: Evidence from Selected Developing Countries' (2010) 37(3) Decision 5, 24.
⁵ The ‘Kingdom of Saudi Arabia’ is the international long official form of the country’s name. However, the international short form ‘Saudi Arabia’ will be used throughout the thesis. The Official name in Arabic is Al-Mamlaka al-Arabiya as-Saudiya.
Chapter 1: General Introduction

and international investment. Saudi Arabia’s economy has grown rapidly, leading to a substantial increase in the investment in the stock market. The Capital Market Law 2003 (CML’03), and the Capital Market Authority (CMA) make a positive and notable contribution to the development of the securities market in Saudi Arabia. As a result, an increased number of companies going public has contributed to the growth of stock market over the past decade. The number of listed companies has increased steadily as has share volume and value. The number of shares traded in 1997 was 312.4 million valued at USD59.4 billion. In 2011 this increased to 48.535 billion, valued at USD341 billion. During the past decade, the number of listed companies has doubled to reach 156 firms listed on the Saudi Stock Exchange (SSE) as at July 2012. This makes the Saudi stock market the largest in the Middle East.

**Figure 1.1 Numbers of Saudi Listed Companies (2001–2012)**

6 Royal Decree No. (M/30) 2 Jumada al-Thani 1424 H [31 July 2003]. Prior to the adoption by the Council of Ministers of the Capital Market Law, Saudi Arabia did not have a stock exchange and there was no regulatory framework facilitating such trading or protecting the interest of investors. See Tim Niblock and Monica Malik, The Political Economy of Saudi Arabia (Routledge, 2007) 190.


8 Chapter 2 will describe in more detail the development of the Saudi securities market.

9 The Saudi Stock Exchange is the largest exchange in the Middle East in terms of the number of IPOs, by market capitalisation and by capital raised. See Saudi Stock Exchange, Tadawul (21 April 2013) <http://www.tadawul.com.sa/wps/portal/ut/p/c0/04_SB8K8xLLM9MSSzPy8xBz9CP0os3hLswCXUE8TwOLIGMTA08XCx_XQC8X1wMDc_3g1DzgmxHRQD5zumD/>.

Nevertheless, the development of the Saudi securities market is not satisfactory compared with the economy of the country. Empirical research classifies the Saudi stock market a ‘weak’ market.\(^\text{11}\) The lack of disclosure and transparency undermine the efficiency of the market.\(^\text{12}\) As a result, investor confidence has been affected as they feel that they are not protected. Proper protection has become a matter of priority for investors in the Saudi securities market. This need is evident from the massive financial crisis in 2006 when the market lost more than 50 per cent of its value.\(^\text{13}\) Because of this collapse, more than 4 million investors suffered devastating financial losses.\(^\text{14}\)

In order to outline the framework of the current study, this chapter is divided into 6 sections. Section 1 is an introduction to the chapter. Section 2 states the problems prevailing in the securities market of Saudi Arabia. Section 3 describes the significance and contribution of the study. Section 4 provides its aims and objectives. Section 5 presents its scope and limitation. Section 6 provides the research questions and sub-questions. Section 7 explains the methodology utilised in this study and its associated data collection. Section 8 presents a summary and conclusions.


\(^{12}\) Fama was the originator of the unique definition of market efficiency by providing that ‘A market in which prices always ‘fully reflect’ available information is called “efficient”.’ Eugene F Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 Journal of Finance 383.

\(^{13}\) The Saudi stock market witnessed six major collapses that resulted in significant depreciation of the general price index during the years of 1986, 1990, 1993, 1994, 1998, 2006, and 2008. This worst was in 2006.

Chapter 1: General Introduction

1.2 Statement of Problem

1.2.1 Lack of Regulation

It is generally accepted that central to the regulation of the financial market is information and that its regulation is necessary because of the existence of informational asymmetry between issuers and their potential investors.\(^{15}\) Loss contended that the general problems of fraud and market manipulation make regulation imperative.\(^{16}\) Regarding investor protection in capital markets, he observed that ‘problems at which modern securities regulation is directed are as old as the cupidity of sellers and the gullibility of buyers’.\(^ {17}\) One of the principal purposes of such regulation is investor protection as is recognised by regulators worldwide, including the International Organisation of Securities Commissions (IOSCO).\(^ {18}\) Several empirical and perhaps most cited studies conducted by a group of researchers in the United States reveal that the sustainable development of stock markets requires adequate protection of investors, and a lack of such protection keeps the investing public away from the market.\(^ {19}\) The regulation of capital markets is regarded as a useful means of providing such protection, which is sought to be achieved by, inter alia, imposing civil liability for defective disclosures.

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\(^{16}\) Louis Loss, Trends in Corporate Governance and Investor Protection (Lagos University, 1981) 33.

\(^{17}\) Louis Loss, Fundamentals of Securities Regulation (Little, Brown and Company, 2\textsuperscript{nd} ed, 1988) 1.


Chapter 1: General Introduction

The need for investor protection has led to the creation of laws and regulations in Saudi Arabia in recent times, and to the appointment of the CMA, which is entrusted with the responsibility of administering these laws. One of the important functions of the CMA is thus to protect investors, inter alia, from defective disclosures by corporations to the public. The regulator aims to provide this protection by preventing defective disclosures from being included in prospectuses, periodic disclosures and continuous disclosure documents.20

As part of enforcement measures to deal with the contraventions of disclosure requirements, the CMA has established a committee known as the ‘Committee for the Resolution of Securities Disputes’ (CRSD), which has jurisdiction over disputes falling under the provisions of CML’03, including corporate disclosures.21 Finally, it should be noted that in 2010, the CMA became an ordinary member of the International Organisation of Securities Commissions (IOSCO).22 The comprehensive protection of investors has, however, not yet been accomplished in the Saudi securities market.

In effect, the Saudi civil liability provisions for defective disclosures are, principally, a direct translation of the equivalent provisions of the US Securities Act 1933 (SA’33).23

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21 See article 25 of the Capital Market Law 2003 (Saudi Arabia): The Committee shall have all necessary powers to investigate and settle complaints and suits, including the power to issue subpoenas, issue decisions, impose sanctions and order the production of evidence and documents.

22 In fulfilling the criteria for membership, the applicants demonstrate their commitment to IOSCO’s Objectives and Principles of Securities Regulation and that their regulatory regimes allow them to become signatories to Appendix A of the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information. For details, see International Organisation of Securities Commissions, 'IOSCO Expands its Global Membership to Include Iceland, the Maldives, Saudi Arabia and Syria’ (Media Release, IOSCO/MS/03/2010, 10 June 2010) <http://www.cmvm.pt/CMVM/Cooperacao%20Internacional/Docs%20Iosco/Documents/IOSCOMS0310.pdf> 7.

Chapter 1: General Introduction

In order for this importation to suit the Saudi securities market conditions, the current securities laws and regulations need to be reviewed and improved to provide sufficient protection for market investors. In terms of examples of how closely the legislation correlates, Beach states that art 55 of the CML’03 closely mirrors the US provision on liability for misrepresentations in a prospectus. In addition, art 56 of the CML’03 is a direct translation of § 18(a) SA’33. It is submitted that ‘transplanting American-style law into another country without taking into account the background culture and legal structure of the country is not effective’.25

Furthermore, ineffective market regulation has a negative impact on the efficiency of the stock market. Using the efficient market hypothesis (EMH) developed by Fama in 1965, a study on the Saudi stock market classifies the stock market as a ‘weak form’ market, which signifies the inefficiency of the stock market. Additionally, the same study also confirms that the market lacks disclosure and transparency regulations for listed companies. Hence, it can be said that the stock prices do not reflect the (officially disclosed) information in the stock market as the market basically lacks transparency and driven by rumours and false information. Nevertheless, the government and securities regulator are not effectively working together in order to

26  There are three types of market efficiency are generally distinguished:
   i. The weak form: where a current price is considered to incorporate all the information contained in past prices.
   ii. The semi-strong form: where a current price incorporates all publicly known information, including its own past prices.
   iii. The strong form: where prices reflect all information that can possibly be known, including privately known information.
For more details, see Fama, above n 12.
28  Ibid 5.
carry out the necessary modification or to introduce any fundamental regulations in the stock market which would foster the financial and monetary policies to encourage people to enter the stock market again.

1.2.2 Inadequate Protection of Investors

The Saudi stock market is one of the largest emerging markets in the world, and has been experiencing growing demands for investment in corporate securities. In recent years, the demand for stock trading and investment portfolios has doubled and the number of subscribers in some of the initial public offerings represents more than 60 per cent of the population. The market witnessed the largest collapse in its history in 2006, causing heavy losses of many investors, especially speculators. The price index lost over 13,000 points (65 per cent of its maximum level). This sudden collapse was caused by widespread defective corporate disclosures and rumour driven trading practice by investors. Niblock and Malik say that ‘substantial responsibility also lay with the character, imperfections and inadequate regulatory arrangement of the market itself’. However, the investors have not yet been compensated. This collapse warrants an in-depth investigation of its causes, implications and remedies from the perspective of civil liability for defective disclosures.

With the increase in initial public offerings and a resultant increase in listed companies, publication of defective disclosures are becoming a common phenomenon in the Saudi

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33 Niblock and Malik, above n 6, 218.
Chapter 1: General Introduction

capital market. This has raised the question of the efficacy of civil liability provisions concerning corporate disclosures. As it stands, there are insufficient laws to cover all breaches made by corporations, their directors and other persons involved in the contraventions. In addition, a lack of transparency, poor corporate governance, broad defences and weak enforcement practice, have made the issue of stock market regulation difficult. A former legal advisor to the CMA claims that despite the fact that disclosure rules are in place, they are not very functional in practice. Moreover, a 2009 empirical study revealed that corporate governance in Saudi Arabia is in its early stages and is characterised by a lack of accountability, a weak legal framework and poor protection of shareholders.

One of the major problems with disclosure in the Saudi stock market is that some people are able to know before others how and when a company will announce material financial disclosures, such as the declaration of dividends. This means that the market lacks integrity and transparency with respect to corporate disclosures. It is important to make full, accurate and timely disclosure of material information to the market in order to protect general investors. This weakness thus necessitates an investigation into the causes contributing to the problem with a view to finding a viable solution. It may be worth mentioning that despite these weaknesses persisting in the Saudi capital market

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34 Many investors sustain losses because of defective disclosures in prospectuses. For example, see Abdullah Bajubayr, 'Please Our Money..O Anti-Corruption Commission', Aleqtisadiah (online), 18 April 2012 <http://www.aleqt.com/2012/04/18/article_648289.html> [Arabic]. Unless otherwise stated, titles of Arabic language texts are translated by the author of this thesis.
38 The term ‘material information’ will be discussed in chapter 4 and 5.
for a long time, there has been no comprehensive research into civil liability for defective disclosures by corporations in Saudi Arabia. In general, disclosure norms and announcement practices in the Saudi securities market are poor. A recent study finds that the lack of sufficient information amongst investors in the Saudi stock market leads to a significant reduction in stock returns.

The lack of investor protection has undermined the growth of the stock market in Saudi Arabia. Investors have become unwilling to enter the market. On the other hand, victims of violations of the law are reluctant to seek remedies due to the uncertainty of indemnification of their damages and loss. Consequently, the current study is going to address the problem of inoperative civil liability for defective corporate disclosures in Saudi stock market from the perspective of investor protection. The weakness of civil liability is necessarily linked to the weak requirements for information disclosure and ineffective enforcement machinery.

1.3 Significance and Benefits of the Study

Disclosure is a fundamental issue of securities laws, as it affects both the market and the conduct of market participants. Disclosures aim to enable the public to make informed investment decisions and are believed to be the ‘holy grail’ of securities markets. Hence the development of an appropriate body of disclosure law is vital to the integrity of securities law and ultimately to the market economy. False and misleading disclosures

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or omission of timely disclosure of material information may ruin investors, damage public confidence, cause the collapse of a securities market and harm the national economy for the long term. Liability is imposed to prevent that harm.

La Porta et al have found that countries with better legal protections for investors have more developed financial markets.\textsuperscript{42} They analysed the securities laws of 49 countries and found that disclosure rights and liability standards were positively correlated with larger stock markets.

The Saudi stock market is associated with a lack of transparency, which was a major reason for the market collapse in 2006. This massive financial catastrophe that hit the Saudi stock market needs immediate investigation to ensure it does not happen again. In order to do this, civil liability for the breach of the disclosure regime has to be reviewed and strengthened as part of necessary legal reforms so that investors can be more protected from disclosure violations.

Effective reforms are necessary for investor protection. However, in Saudi Arabia a number of impediments to this exist, such as, an absence of academic literature in the field of securities law in Saudi Arabia, weak investor confidence in the securities market, lack of transparency and disclosure, weak civil liability, and ineffective judicial enforcement and administrative enforcement of the disclosure regime. These impediments would impact on the effective reform of the securities market in Saudi Arabia. Hence, by addressing the above issues, the present study attempts to propose legal reforms in order to strengthen the protection of investors, and improve the integrity of the securities market as well as the economy of the country.

\textsuperscript{42} La Porta, Lopez-De-Silanes and Shleifer, above n 4, 27.
Chapter 1: General Introduction

Although the Saudi stock market is considered the largest market in the Gulf Cooperation Council (GCC), the Arab world and the Middle Eastern region, the market remains characterised by a lack of transparency. Therefore, improving the accuracy of disclosures is essential for the investor protection as well as the development of market.

Furthermore, the importance of this study derives from the strong correlation between the stock market and the country’s economy. Having a developed stock market is significant for the development of the private sector and the entire country as well. The securities market must be attractive to investors so that the public can have confidence and invest in the ‘initial public offering’ (IPO) and trade in the secondary market. Hence, having appropriate education programs is essential for investors and intermediaries in order for them to be able to assess financial information and make an informed investment decision. This highlights the role of the securities regulator (CMA) in the adoption of such programs and in issuing further rules in this regard as part of its role as the supervisor of the market.

However, as alluded to earlier, the current legal and regulatory framework for corporate disclosure in Saudi Arabia is weak and ineffective. Given the importance of full, fair and timely disclosure of material or price sensitive information by corporations and enforcement of those requirements for investors, markets and national economies alike (as discussed above), the area of this study warrants an in-depth investigation of its

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43 The GCC is a political and economic union of the Arab states bordering the Arab Gulf, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

44 The Middle East region consists of Afghanistan, Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Pakistan, Qatar, Saudi Arabia, Syria, United Arab Emirates (UAE), West Bank and Gaza, and Yemen. Sometimes the region is grouped with North African countries, together known as the MENA (Middle East and North Africa) region, and includes Algeria, Djibouti, Libya, Mauritania, Morocco, Somalia, Sudan, and Tunisia.
various aspects as identified in the discussion of the study’s objectives. Despite the importance of this area, no comprehensive study — to the best of this researcher’s knowledge — has been carried out to date addressing the concerns that this study intends to address. This lack of investigation demonstrates the justification for and significance of undertaking this study.

With the absence of academic literature in the field of securities laws in Saudi Arabia, this study may fill the gap in this regard. The securities markets in Middle East countries in general and Saudi Arabia in particular may immensely benefit from the outcomes of this study, which is intended to produce a set of reform proposals with a view to intensifying investor protection and thereby developing robust securities markets in the region. The current study identifies areas of further future research as a continued effort to achieve vibrant capital markets in the countries of the Middle East.

1.4 Aims and Objectives of the Study

The principal aim of this study is to improve the legal regime of investor protection in the securities market in Saudi Arabia. In addition, it aims to increase local and foreign portfolio investment in the country by generating and maintaining public confidence in the securities market. Hence, formulating a legal and regulatory framework for corporate civil liability is a major aim of this study.

In order to achieve these aims, this study has a number of objectives. The present study intends to critically examine the current corporate disclosure provisions concerning initial public offerings, periodic disclosures, and continuous disclosures in Saudi Arabia. This study also makes an effort to identify and analyse what conduct constitutes civil wrongs attracting civil liability under the current legal framework. Moreover, an
Chapter 1: General Introduction

examination of who can be held civilly liable for wrongdoings and an assessment of the merits of the defences that are available to avoid such liability will be undertaken within the objectives of the present study. Further discussion is presented in this study regarding those who are entitled to seek civil remedies for contraventions of disclosure requirements. For this reason, this study tries to identify the shortcomings and weaknesses of laws governing the disclosure regime, civil liability for defective disclosures, and the efficiency of the judicial enforcement. Furthermore, the current study seeks to critically evaluate the role of the market regulator in protecting investors and investigating the effectiveness of the judicial enforcement. Finally, the present study intends to provide suggestions for further improvement of the relevant laws and regulation in Saudi Arabia.

1. 5 Scope and Limitation of the Study

The present study is concerned with the current disclosure requirements for prospectuses, and continuous and periodic disclosures in Saudi securities market. It focuses on civil liability resulting from non-compliance with these requirements and the enforcement machinery of the disclosure requirements and civil liability for the breach of these requirements.

The first two substantive chapters, chapters 4 and 5, compare and evaluate the civil liability provisions for breaches of the disclosure regime in Saudi Arabia and the selected developed countries — the United States (US), United Kingdom (UK), Australia and Canada. First, these two chapters discuss the disclosure requirements for a

45 Obligations and liability for prospectuses, periodic disclosures and continuous disclosures are found and defined in the Capital Market Law 2003 (Saudi Arabia), Listing Rules 2004 (Saudi Arabia) and Market Conduct Regulations 2004 (Saudi Arabia). However, this thesis will attempt an in-depth analysis of the disclosure regime, the civil liability for the breaches of this regime and the enforcement machinery.
Chapter 1: General Introduction

prospectus, and for continuous disclosure and periodic disclosure in Saudi Arabia and the selected countries.\footnote{Ibid.} Second, the Saudi civil liability provisions for breaches of the disclosure requirements are evaluated in comparison with civil liability provisions in the selected countries. The study considers the liability of the company as a separate entity, and that of its directors, officers, underwriters and professionals involved in the preparation and issuance of a prospectus.

The subsequent two chapters, chapters 6 and 7, continue to evaluate the civil liability provisions in two main divisions. First, it provides and evaluates the remedies available to investors for breaches of the disclosure regime, and second, it discusses the available defences against civil liability for defective disclosures. In addition, evidence in securities litigation is briefly discussed due to the importance of evidence in a claim for civil liability and defences against such liability.

The final two chapters of this thesis (apart from the concluding chapter) are dedicated to studying the enforcement machinery for securities laws and attempt to establish the arguments that the judicial and administrative enforcement of the disclosure regime in Saudi Arabia is not fully capable of providing protection for investors in the securities market. Thus, the judicial enforcement chapter (Chapter 8) addresses the judicial institutions for securities litigations in the terms of their composition, members and performance. Likewise, the role played by the CMA in enforcing the disclosure regime is thoroughly discussed in Chapter 9. The functions of the CMA in protecting investors from defective disclosures have been addressed in the terms of pre-violation and post-violation of the disclosure regime.
Chapter 1: General Introduction

While this thesis is confined to studying investor protection through civil liability for breach of the disclosure regime, it is difficult to address properly all the issues concerned with investor protection in a single thesis. Therefore, further issues encompassed by investor protection in securities market have been excluded from the present thesis. These further issues include controlling misleading, manipulative or fraudulent practices such as insider trading, ‘front running’ or trading ahead of customers and the misuse of client assets, and so on.

1.6 Research Questions and Sub-Questions

The main research questions for this study are:

i. What are the strengths and weaknesses of the civil liability regime for corporate disclosures in Saudi Arabia in order to protect investors?

ii. How can the Saudi corporate disclosure regime be further improved to protect investors?

The above research questions have been chosen based on the fact that the current Saudi corporate disclosure provisions are flawed and ineffective in terms of civil liability and their enforcement in practice. The following sub-questions need to be addressed in the proposed study in search of answers to the main questions listed above.

Relevant Sub-Questions:

i. What is the importance of investor protection in the Saudi securities market?

ii. What are the objectives of disclosures in prospectuses, and periodic and continuous disclosure documents under Saudi law?
Chapter 1: General Introduction

iii. Are the present requirements adequate to ensure full, fair and timely disclosure of material information by corporations in Saudi Arabia?

iv. What is the scope of contravention of these requirements which would attract civil liability?

v. Who can be held liable for a disclosure containing untrue and misleading information under Saudi law?

vi. What defences are available to escape liability, and how and when can these defences be relied upon?

vii. What remedies are available for breaches of civil liability provisions for defective disclosures?

viii. Are the present remedies adequate to compensate victims and to create deterrence against contraventions?

ix. What are the strengths and weaknesses of the judicial enforcement of the disclosure requirements currently in place in Saudi Arabia?

x. What are the strengths and weaknesses of the administrative enforcement of these requirements and how effective is the role of the market regulator in protecting securities investors in Saudi Arabia?

xi. How can the enforcement regime be further strengthened in Saudi Arabia?

1.7 Research Methodology and Data Collection

This thesis has been conducted based on archival primary and secondary materials which have been collected from different libraries in Australia and Saudi Arabia, and from the electronic sources available especially from the library of the University of Wollongong. Interlibrary borrowing services have been used in collecting materials
which are not available otherwise. A field-trip to Saudi Arabia was also completed in order to collect materials related to the topic of the current research.

This research study is designed to cater for the need to conduct a comprehensive study on the legal and regulatory framework for corporate disclosures in Saudi Arabia. The legal system of Saudi Arabia is based on Islamic law (Shari’ah). Most of the legal principles currently in force in the country are derived from the sources of Shari’ah. When any rules or principles from different legal systems are adopted, they must be able to conform or be consonant with Shari’ah. In such a case, there should not remain any contradiction between Shari’ah and traditional laws. Any rule or principle is Islamic unless it conflicts with Shari’ah.

It is, however, pertinent to mention that despite the fact that the country’s law largely originates in Shari’ah, the body of commercial law is composed of both Shari’ah and civil as well as common law principles. This implies that Saudi Arabia has the flexibility to adopt useful provisions of corporate law from other jurisdictions in order to improve its corporate regulation. Moreover, the securities laws of Saudi Arabia were originally drafted by hired academics and scholars in line with similar laws of the US as it will be shown in Chapter 3.47 Hence, the Saudi laws of securities regulation have been reliant upon their equivalent in developed nations from their inception. Therefore, in addition to the US jurisdictions, the major common law jurisdictions have been examined as potential sources of suitable legislative provisions.

Having regard to this, the discussion in this thesis will use the civil liability provisions for defective disclosures from selected developed countries, these being the US, the UK,

47 For more information, see below section 3.3.1.
Australia and Canada. These jurisdictions are selected on the basis of the strength of their improved securities regulatory regimes and the success of their markets. A justification for this selection is that it is believed that the common law jurisdictions appear to be much more active enforcers than civil law jurisdictions. A study of 49 countries demonstrated that common law countries had more extensive mandatory disclosure requirements, and made it easier for investors to recover damages. Moreover, the civil liability provisions in the CML’03 are similar to their equivalents in the SA’33. However, in this thesis, it will be demonstrated that in Saudi Arabia simply copying laws from one jurisdiction to another without having an effective regulatory body and enforcement mechanism is not successful, hence, it seems justifiable to borrow further from common law countries in regard to these and other shortcomings. This is particularly the case as capital flow is international in nature and greater commonality and assurance would facilitate inflows to Saudi Arabia as well as increased confidence in the domestic market.

In Australia and the UK, securities markets are centrally regulated, which is in contrast to the situation in the US and Canada. In the US, there are two different regulations: one is for the state level and the other is at the federal level. In respect of corporate disclosure liability, the US federal securities laws will be used in this thesis. In regard to Canada, where federal securities regulation does not exist, the regulatory regime of the Province of Ontario will be used. This province has the nation’s largest capital market and one of its most stringent and sophisticated securities regulatory regimes. In all other developed countries mentioned above, the laws on national regulation of their securities

49 La Porta, Lopez-De-Silanes and Shleifer, above n 4, 17-28.
50 Beach, above n 24.
markets have been taken into account in this thesis. Disclosure rules and regulations issued by securities regulator of Saudi Arabia (the CMA) and those of other selected countries will be examined in this thesis.\(^{51}\)

The regulation of corporations is an area of law where commonality of principles in many respects is desirable, regardless of the origins of the legal systems concerned. This includes, for example, what conduct should be civilly prohibited, who should be held liable for defective disclosures, what defences should be allowed to avoid liability or what remedies should be made available to the victims, and so on.

Furthermore, the laws that govern the civil liability for defective disclosures in Saudi Arabia will be examined from a comparative perspective. The principles and objectives of the securities regulation set out by IOSCO and their current application in Saudi Arabia will also be investigated. In recent years, IOSCO has demonstrated tremendous success in raising the quality of securities market regulation and in strengthening consultation and cooperation between regulators. This has been one of the organisation’s key achievements.\(^{52}\) Saudi Arabia, as well as the other countries whose jurisdictions are referred to in this thesis, are members of IOSCO.

As this study will be confined to the jurisdictions of the US, UK, Canada and Australia in regard to the discussion of the questions listed earlier, it will adopt a moderate view in selecting useful legal provisions from these selected developed jurisdictions in order

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\(^{51}\) These securities regulators are:
- Capital Market Authority (CMA), Saudi Arabia.
- Australia Securities & Investment Commission (ASIC), Australia.
- Ontario Securities Commission (OSC), Canada.
- Financial Services Authority (FSA), United Kingdom.

Chapter 1: General Introduction

to improve their equivalents in Saudi Arabia. However, adequate and appropriate arguments will be provided in every case where the adoption of legal principles from foreign jurisdictions is recommended for incorporation in Saudi law.

To achieve the objectives of the study, the following methods are employed:

i. Collection of all primary relevant primary and secondary materials;

ii. Review of the secondary literature on laws and regulations concerning investor protection in the securities market;

iii. Analysis of the relevant statutes and by-laws of Saudi Arabia and the selected developed jurisdictions;

iv. Discovery of suitable case law to be used when it is needed throughout the analysis;

v. Examination of media releases, newspaper articles, the opinions of commentators and experts on the operation of the SSE and the legal and regulatory framework of the securities market in Saudi Arabia;

vi. Analysis of the available statistical data and public records issued by the government, the CMA and the SSE.

It should be noted that the present study will assess the enforcement of civil liability and the role of the securities regulator in Saudi Arabia without a full survey of the situation in the above selected developed jurisdictions. This can be justified by the fact that, unlike developed countries, judges and lawyers in Saudi Arabia are not well-trained and not expert in securities. In addition, the CMA members lack legal education and experience in the private sector as well as the well-trained staff to deal with, detect and investigate violations of the disclosure rules. However, some useful standards and
practices from the developed countries will be used carefully and selectively in order to strengthen the enforcement regime of securities laws in Saudi Arabia.

As has been mentioned earlier, the literature on the topic of this thesis in Saudi Arabia is extremely limited and in regard to some issues non-existent. The vast majority of materials in this thesis are available in English. In instances where Arabic sources are cited, the author of this thesis has translated the titles of Arabic sources into English and indicated that in brackets [Arabic]. Due to the paucity of Saudi cases, mostly the case law of the selected common law countries has been used.

1.8 Summary and Conclusions

The existence of weak investor protection has been recognised as the principal problem in the Saudi securities market. It has been submitted that the weak legal and regulatory framework of the securities market produce weak protection for investors in the Saudi securities market. In addition, it has been identified that investor protection is primarily undermined by the ineffective disclosure requirements as well as the weak application of civil liability provisions for breaches of these requirements.

Despite these weaknesses, the laws and regulations dealing with investor protection have not been comprehensively examined. Hence, this study will be the first of its kind which investigates investor protection and civil liability for defective disclosures in prospectuses and in continuous and periodic disclosures in Saudi Arabia. The proposed study intends to produce a set of reform proposals with a view to strengthening investor protection and thereby facilitate the development of robust securities markets in Saudi Arabia.
Chapter 1: General Introduction

This research provides specific suggestions and recommendations for the development of the current legal and regulatory laws relating to investor protection. Hence, the results of this study may encourage the governmental authorities to carry out additional efforts to protect investors in the capital market. Additionally, academic research may benefit from this attempt to improve the legal and the regulatory framework of the Saudi securities market.
CHAPTER 2: INTRODUCTION TO SAUDI ARABIA, ITS SECURITIES MARKET AND RELEVANT CONCEPTS

2.1 Introduction

Following the general introduction which outlined the main concerns of this study, this chapter aims to look at some introductory issues which are relevant to this research. This chapter will provide a brief background to Saudi Arabia and its legal system and the securities market from its inception\(^{53}\) and demonstrate the gradual development of the market from 1935 to 2011. Moreover, attention will be drawn to the issues affecting the development of the market and will be highlighted from both an economic and a legal perspective. This chapter will look at some introductory conceptual and terminology issues. It will identify the major terms and concepts relating to the concerns of this thesis. Hence, this chapter is divided into a number of sections. An introduction to the chapter is in section 1. Section 2 introduces Saudi Arabia as an independent country and explains the legal system in Saudi Arabia. Section 3 introduces the securities market in Saudi Arabia. Section 4 explains the inception of the Saudi securities market in 1935 and its gradual development up until 2011 as well as providing a comparison between the position of the Saudi securities market and its regional and international counterparts. Section 5 discusses the major drawbacks associated with the development of the Saudi securities market from an economic perspective. Section 6 provides the reasons for weak investor protection on the development of the Saudi securities market. Section 7 discusses the main terms and concepts that are the concern of this thesis. Section 8 emphasises the importance of the disclosure regime and the civil liability in relation to investor protection and the

\(^{53}\) The terms ‘securities market’, ‘stock market’ and ‘share market’ will be used interchangeably.
development of the market. Section 9 comprises a summary of the discussions and conclusions.

2.2 Background to Saudi Arabia

The history and development of the Arabian Peninsula and Saudi Arabia in particular have been deeply influenced by Islam. In the 18th century, a religious scholar of the central Najd, Muhammad bin Abdul Wahhab, joined forces with Muhammad bin Saud, the ruler of the town of Diriyah, to bring the Najd and the rest of Arabia back to what adherents believe is the original and undefiled form of Islam.

The 23rd of September 1932 marks the foundation of the modern Kingdom of Saudi Arabia. The Kingdom of Saudi Arabia is the heartland of Islam, the birthplace of its history, the site of the two holy mosques (Al-Masjid al-Haram in Mecca and Al-Masjid al-Nabawi in Medina), which makes it the geographical focus of Islamic devotion and prayer.

The political system of Saudi Arabia is a monarchy. The King is the ruler of the country, the prime minister of the government and the commander-in-chief of the military. A legislative body called the majlis ash-shura (the Consultative Council)

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54 Najd is the central region of Arabian Peninsula.
57 Basic Law of Governance 1992 (Saudi Arabia) art 5 declares that ‘Monarchy is the system of rule in the Kingdom of Saudi Arabia, and rulers of the country shall be from amongst the sons of the founder King Abdulaziz bin Abdulrahman Al-Faisal Al-Saud, and their descendants.’
advices the King.\textsuperscript{58} The Council proposes new laws and amends existing ones. It consists of 150 members who are appointed by the King for a renewable four-year term.

The country is divided into 13 provinces, with a governor and deputy governor in each one. Each province has its own council that advises the governor and deals with the development of the province. The national language of Saudi Arabia is Arabic. The country’s population is 27 million, including 8.4 million foreign residents (according to the 2010 census).\textsuperscript{59} Saudi Arabia is the largest country in the Middle East and the twelfth largest in the world in terms of geographic size.\textsuperscript{60}

\textbf{Figure 2.2 Map of Saudi Arabia}\textsuperscript{61}

\textsuperscript{58} \textit{Majlis ash-shura} is a legislative body that advises the King on issues that are important to the State. See Hamdallah M Hamdallah, \textit{Saudi Commercial Law} (Khawarizm for Publications and Distribution, 2\textsuperscript{nd} ed, 2004) [Arabic] 21.


\textsuperscript{60} Saudi Arabia is about 2.2 million square kilometres in area. Sajjad M Jasimuddin, 'Analyzing the Competitive Advantages of Saudi Arabia with Porter’s Model' (2001) 16 \textit{Journal of Business and Industrial Marketing} 59, 59.

\textsuperscript{61} Map of Saudi Arabia (10 July 2012) <http://www.lib.utexas.edu/maps/atlas_middle_east/saudi_arabia.jpg>.
Saudi Arabia is a founding member of the Gulf Cooperation Council (GCC), United Nations, League of Arab States, Organisation of the Islamic Conference (OIC), and Organisation of Petroleum Exporting Countries (OPEC); a member of many international organisations, including the World Bank, the International Monetary Fund, and the World Trade Organisation (WTO); and a signatory to the Nuclear Non-Proliferation Treaty. Saudi Arabia is part of the world Group of Twenty Finance Ministers and Central Bank Governors, which is also known as the ‘G20’. The G20 consists of 20 major economies: 19 countries plus the European Union.

Saudi Arabia has the largest economy in the entire Middle East with the largest banking sector and capital market, and is the region’s largest exporter and importer of goods.\(^{62}\)

In 2010, Saudi Arabia’s GDP was estimated to be USD622.5 billion, making it 23\(^{rd}\) in the world.\(^ {63}\) Saudi Arabia is the world’s leading oil producer, and exporter and the owner of a quarter of all proven oil reserves. Oil accounts for more than 90 per cent of the country’s exports and from 80 to 90 per cent of total export earnings, which represents more than 75 per cent of the government’s annual budget. In fact, the Saudi economy is commonly considered a small, open, oil-based economy.\(^ {64}\)

2.2.1 Saudi Arabia and Its Legal System

Islam, as the religion of the vast majority of the population, forms the foundation of the legal and commercial systems in Saudi Arabia.\(^ {65}\) Hence, the legal system of Saudi

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\(^{62}\) Shoult, ‘Country Overview’, above n 56, (Foreword).


67 Cassell and Black, above n 63.
70 Islamic law is known as _Shari‘ah_. Also, _Shariah_ and _Sharia_ are other spellings in common usage.
Holy Qur’an and the Sunnah, and according to laws which are decreed by the ruler in agreement with the Holy Qur’an and the Sunnah.73

However, a study on the legal system of Saudi Arabia finds that a combination of specific written laws has created the constitution of Saudi Arabia.74 In addition to the BLG’92, these written laws are the Consultative Council Law 1992, the Law of Regions 1992, the Law of Council Ministers 1994 and the Law of the Judiciary 2007.75

Currently, Saudi Arabia has a dual judicial system comprised of the Shari’ah Courts System (al-Mahakim al-Shariy’ah) and an independent administrative judiciary known as the Board of Grievances (Diwan Al-Mazalem). In addition to the previous judicial bodies, several Administrative Committees have jurisdiction to hear certain specified cases. Moreover, the Law of Judiciary 2007 (LJ’07) permits the establishment of specialised courts by ‘Royal Order on the recommendation of the Supreme Judicial Council’.76 There are two specialised courts within the Shari’ah Courts System: the Courts of Guarantee and Marriages, which exercise jurisdiction over civil suits regarding marriage and divorce, as well as child custody; and the Juvenile Court, which hears juvenile delinquency cases. According to the LJ’07 and the BLG’92, Shari’ah Courts have jurisdiction over all disputes and crimes except those exempted from their jurisdiction by law. Shari’ah Courts hear cases related to personal status, family affairs, civil disputes and most criminal cases. However, different laws and regulations have granted jurisdiction over different claims and crimes to either the Board of Grievances or to Administrative Committees.

73 Basic Law of Governance 1992 (Saudi Arabia) art 48. Also, see arts 1 and 7.
75 Ibid.
Figure 2.3: The Judicial System in Saudi Arabia

Supreme Council of the Judiciary

First-Degree Court

Labour Courts
Commercial Courts
Criminal Courts
Personal Status Courts
General Courts

Court of Appeals
Labour Circuits
Commercial Circuits
Criminal Circuits
Personal Status Circuits
Civil Circuits

the High Court

Board of Grievances

Administrative Court
Disciplinary Circuits
Administrative Circuits
Subsidiary Circuits
Other Specialised Circuits

Administrative Courts of Appeals
Disciplinary Circuits
Administrative Circuits
Subsidiary Circuits
Other Specialised Circuits

the High Administrative Court
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

There are several ‘Administrative Committees’ with judicial powers which have been periodically created since the unification of Saudi Arabia in 1932. These Administrative Committees have jurisdiction over civil, commercial, administrative and criminal cases and disputes arising out of the implementation of several laws and provisions. The jurisdiction of each committee is determined by the decree that created it.77

Over the past few years, the Saudi government has issued a number of laws and regulations, including the Saudi Capital Market Law 2003 (CML’03),78 Code of Law Practice 2001 (CLP’01),79 Law of Criminal Procedure 2001 (LCP’01),80 and Law of Procedure before Shari’ah Courts 2000 (LPSC’00).81

Vogel states that Saudi Arabia is the most traditionalist Islamic legal system in the world today.82 While this is partly true, Saudi law is more comprehensive than Shari’ah, in the sense that Saudi law includes Islamic law and the codes and regulations adapted from other laws within the sphere of the Shari’ah principles. 83 For example, the Banking Control Law 1966 (BCL’66) shows the way in which Saudi legislators deal with activities prohibited under Shari’ah.84

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77 Examples of current Saudi administrative committees are as follows:
- The Tax Committees;
- The Committees for Penalising Traffic Violations;
- The Mining Disputes Committee;
- The Fraud, Cheating and Speculation Committee;
- The Banking Disputes Settlement Committee; and,
- The Copyright Committee.

78 Royal Decree No. (M/30) 2 Jumada al-Thani 1424 H [31 July 2003].
79 Royal Decree No. (M/38) 28 Rajab 1422 [15 October 2001].
80 Royal Decree No. (M/39) 28 Rajab 1422 [15 October 2001].
81 Royal Decree No. (M/21) 20 Jumada 1421 [19 August 2000].
82 Frank E Vogel, Islamic Law and Legal System: Studies of Saudi Arabia (Brill, 2000) XIV.
84 Ibid.
The formation and operation of private companies are regulated by the *Companies Law 1965* (CL’65),\(^85\) as amended in 1967 and 1982 by subsequent Royal Decrees.\(^86\) The CL’65 does not regulate the participants in the Saudi Stock Exchange (SSE) and their activities. Only the *Capital Market Law 2003* (CML’03) and the rules and regulation of the Capital Market Authority (CMA) have jurisdiction over the primary and secondary market parties and activities in Saudi Arabia.

### 2.3 Introduction to the Securities Market

Financial markets may be divided into two parts, namely, the money market and the capital market. ‘Money markets’ refer to markets that deal with short-term securities.\(^87\) The capital market is a long-term market and consists of securities having maturities longer than one year.\(^88\) Hence, the securities market that this thesis is concerned with is the capital market. It is also generally known as ‘stock market’ and ‘share market’. These terms will be used interchangeably throughout the thesis.

A securities market is a market place where funds are raised for commercial and investment enterprises and where securities in public companies are bought and sold. There are essentially two types of securities markets: primary and the secondary markets.

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\(^85\) Issued under *Royal Decree No. M/6 [22 July 1965]*. According to this decree, a company is defined as ‘a contract pursuant to which each of two or more persons undertake to participate, in an enterprise aiming at profit, by offering in specie or as work share, for sharing in the profits or losses resulting from such enterprise’.


\(^87\) Securities in money market are, for example, treasury bills, commercial paper sold by corporations to finance their daily operations, or certificates of deposit with maturities of less than one year sold by banks: Stanley B Block, Geoffrey A Hirt and Bartley R Danielson, *Foundations of Financial Management* (McGraw-Hill Irwin, 13th ed, 2009) 15.

\(^88\) Ibid 443.
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

The primary market is a market where the initial fund raising is made by way of the sale of new securities. Thus, securities are offered to the public for subscription for the purpose of raising capital or funds. A securities issuer can be a corporation\(^89\) or other entity that issues securities. A primary market transaction that is usually referred to as a ‘distribution’ takes effect where the issuer sells its own securities or sells them through the services of an underwriter.

Issuers have two ways to sell their securities. The first is ‘private placement’, which is a direct sale by the issuer to specific investors, generally institutional investors. Unlike private placements that often target specific investors, the second method to sell issuers securities does not, and is known as an ‘initial public offering’ (IPO). The IPO takes place when an issuer offers securities to the public at large.

The secondary market refers to a market where securities are traded after being initially issued in the primary market and listed on the stock exchange. Trading in this market is called ‘secondary’ because ‘funds flow among investors, rather than to the corporations’.\(^90\) It is also called ‘after-market trading activity’. The majority of trading is done in the secondary market.

2.3.1 The Role and Function of Securities Markets

Securities markets perform two important functions. First, they are mechanisms which facilitate the transfer of investible funds from economic agents in financial surplus to those in financial deficit. This is undertaken by selling securities, shares or bonds to

\(^89\) The American term ‘corporation’ and the British term ‘company’ will be used interchangeably throughout the thesis.

\(^90\) Block, Hirt and Danielson, above n 87, 451.
those with surplus funds. As a result, companies have access to a larger pool of capital. This is the so-called primary market where new issues of securities are arranged in the form of an offer to investors. The second function of the securities market is acting as a secondary market for securities which may have been issued at some time in the past. This market allows securities holders to trade and assures them a degree of liquidity. Indeed, the existence of a secondary market makes the primary market operate more effectively. Investors will be more attracted to and be confidently involved in a new issue because they will be able to turn their investment back into cash at any time.

In the past few decades, attention to the connection between financial development and economic growth has considerably increased. This is because financial development can increase the growth of the economy through various channels. Securities markets are considered an effective channel for financial development. Recent studies have identified a long-term relationship between growth in the securities market and financial growth. They also revealed that stock market liquidity helps to improve the future economy. Consequently, the securities market has a significant role to play in every country’s economy as a whole.

In terms of current economic development in Saudi Arabia, the Saudi stock market can play a vital role in the economic growth of the country. The creation and operation of a sufficiently strong stock market is critical to any national economy.

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92 Ibid.
95 Ibid.
2.3.2 The Importance of the Securities Market in Saudi Arabia

There are numerous advantages of having a stock market at the national level. Firstly, it gives the public an opportunity to invest their savings in government securities and to finance the establishment of new corporations in different sectors and activities. 96 Secondly, the expansion of the establishment of corporations in different sectors greatly benefits the national economy by enriching both private and public sectors. It stimulates the private sector and increases its growth rate, thus increasing the Gross Domestic Product (GDP) from non-petroleum products in Saudi Arabia. 97 Thirdly, an increase in the number of corporations could lead to the raising of production efficiency in the private sector and thus enhance its performance as well as that of the stock market. 98 Fourthly, investment in the share market can reduce inflation risks and also the erosion of the value of the currency. 99 Fifthly, one feature of the share market is that it offers the possibility of converting shares into cash in times of need. Sixthly, the demand for equity investment by the public leads to increased investor awareness and helps to develop amongst the public the concept of saving and investment, as well as helping to develop the concept of collective action in economic and investment activities. 100 Hence, the smaller depositors can confidently put their money into the investment market.

98 Felemban, above n 96.
100 Felemban, above n 96, 120.
Based on the above, it can be seen that a growing capital market ‘provides the necessary mechanism to tap into the large domestic capital locked away in bank accounts’.\textsuperscript{101} It will also support economic diversity, especially within a country that is heavily dependent on its oil exports for revenue. A robust securities market encourages more public offerings, which will finance small and medium-sized businesses and so facilitate greater participation in the country’s economy.\textsuperscript{102} It also allows companies to effectively carry out development projects and thereby support the national economy.\textsuperscript{103} Thus, such capital market growth helps recycle capital surpluses, especially those held by the private sector,\textsuperscript{104} which creates a more resilient, complex and mature national economy.

The share investment environment in Saudi Arabia is promising due to the country’s economic, political and social stability.

\textbf{2.4 The Development of the Securities Market in Saudi Arabia}

The development of the securities market in Saudi Arabia has occurred in three major stages. The first is the period from the inception of the stock market until the year 1984. The second is the development of the stock market during the period 1984–2002. The third is from 2003 until 2011. This section aims to describe the major development during each of these three periods.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{101} Beach, above n 24, 307.
\item \textsuperscript{102} Ibid 308.
\item \textsuperscript{103} Felemban, above n 96, 110.
\end{itemize}
\end{footnotesize}
2.4.1 The Inception and Development of the Saudi Securities Market 1935–1984

Trading in stocks and shares in Saudi Arabia began in 1935 with the establishment of the Arab Automobile Company.\textsuperscript{105} Although such activities remained irregular from 1935 until the 1970s, this period is marked by two important events: the establishment of Riyad Bank as the first company for banking services with its capital of SAR 50 million (USD 13.3 million) divided into 50,000 shares; and the emergence of mixed companies, such as the Arab Petroleum Services Company (APSCO) in 1960 and the Arabian Drilling Company in 1963.\textsuperscript{106} As a result, by 1964 the number of corporations established had reached 17.\textsuperscript{107} Their establishment at that time was due to the necessity of meeting the basic development needs of the country.\textsuperscript{108} Then, during the ten years that followed, the focus on providing electricity services throughout the country led to the establishment of a further 31 corporations. As a result, by 1974 the number of corporations had grown to 54.\textsuperscript{109} The establishment of new corporations continued, and by 1984 they numbered 61. There was a rapid increase in the country’s financial resources during this period, which led to the development of substantial infrastructure projects and helped support the growth of the private sector. As individuals and small

\textsuperscript{105} The Arab Automobile Company was a ‘joint stock company’, which is a company in which the stock or capital is held by a number of persons jointly, the capital being divided into shares. See Peter E Nygh and Peter Butt (eds), \textit{Butterworths Business and Law Dictionary} (LexisNexis Butterworth, 2\textsuperscript{nd} ed, 2002) 283. The term ‘joint stock company’ is commonly used by Saudi scholars and agencies when their work is translated to English language. However, in this thesis the use of the term ‘corporation’ is preferred, as the law treats a corporation as a separate legal entity.

\textsuperscript{106} In this thesis, the term ‘a mixed company’ is used to signify that foreign capital has been contributed to the capital of a company.

\textsuperscript{107} The combined capital of these corporations reached SAR 2955 million (USD 788 million), and 29 million shares.

\textsuperscript{108} The purpose of the establishment of these early corporations in the period 1935–1964 was to provide the country with the basic needs such as electricity services, building materials and to facilitate the utilisation of oil resources.

\textsuperscript{109} The combined capital of these 54 corporations reached SAR 6509 million (USD 1736 million), and 44.8 million shares.
institutions could not finance projects such as these that required large capital expenditure, the need to establish corporations continued to rise.

Furthermore, it can also be clearly seen from records of the time that the significant increase in the number and size of corporations was largely due to government contributions to the capital of leading corporations.\footnote{For instance, the government established the ‘Saudi Basic Industries Corporation’ (SABIC) and 30% of the corporation’s shares were offered to public. Also, the government contributed 20% of the capital of the ‘Agricultural Development Corporation’ and 40% of the capital of the ‘Saudi Fisheries Company’.} Several leading corporations also contributed to the establishment of additional corporations.\footnote{For example, ‘Saudi Public Transport Co’ owns a large share of the capital of Saudi Automotive Services Co.}

The Saudi economy significantly increased during the period post-1974 due to the considerable increase in financial resources.\footnote{This increase itself was due to increased oil production and rising world prices in the 1970s.} This period witnessed a significant increase in the understanding and acceptance of the concept of investment amongst Saudi people, a process that was assisted by the coming into existence of a number of markets in neighbouring Arab countries.\footnote{Such as the Beirut Stock Exchange, which was founded in 1967; and the issuance of laws and regulations in Kuwait, which was a preliminary stage to the establishment of the Kuwait Stock Exchange in 1977. The Amman Stock Exchange opened in the 1978/79 financial year.} These events undoubtedly created a large base of people interested in this type of investment. The country’s development needs created a suitable environment for the expansion of all types of investment.

Share trading in Saudi Arabia remained sporadic from its inception until the privatisation of several electricity companies in the second half of the 1970s. Therefore, it can be said that informal stock market trading commenced in Saudi Arabia in 1975 when the merger of electricity companies in the eastern regions with those in the central and southern regions resulted in additional shares being made available to shareholders at no cost, and this in turn resulted in an increase in the number of shares available for
trading in the market.\footnote{Abdullah M Al-Razeen,} As a result, several real estate agencies and other informal offices, started to act as securities brokers, either on their own account or for a customer’s brokerage account. This activity was limited and irregular,\footnote{Felemban, above n 96, 100.} but it is commonly observed that the Saudi stock market dates from the second half of 1970s. However, it was informal in both its inception and operation.

From 1975 until 1984, gradual development was the hallmark of the securities market in Saudi Arabia. The Saudi government commenced the nationalisation of foreign banks operating inside the country.\footnote{From 1975 to 1984, nine foreign banks were nationalised, with total capital funds of SAR 1750 million. The number of shares issued was 17.5 million, of which Saudi citizens own 60.6%.} As a result, the government offered shares in these foreign banks for public subscription. This led to an increasing demand for shares until 1984. Several important factors contributed to this development. Felemban identifies the following three factors:

i. The increase in the savings of individuals during the years of economic revival;

ii. The revival of the stock market due to company profits being distributed to shareholders;

iii. The stage of growth and expansion reached by many corporations established before 1970.\footnote{Felemban, above n 96, 101.}

These factors strongly contributed to making investment in the securities market attractive to the public, especially in terms of the initial subscription in the shares of new corporations. On the other hand, the increase in initial public offerings led to a
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

growth in the number and size of irregular brokerage firms and to competing advertisements in the local press.118

An additional development to that of the securities market in Saudi Arabia was the adoption of a specific share allocation policy by the Ministry of Commerce.119 This policy encouraged an expansion in the number of investors, thus creating a broadening of the scope of investment in the share market. Furthermore, mutual funds were first introduced in the Saudi Market by the National Commercial Bank (NCB) through its open-ended Al Ahli Short-Term Dollar Fund in 1979.120 The retail investor was the target market of mutual funds that rapidly became a success due to the funds’ low service charges, and ease of entry and redemption.121

The securities market also was marred by several illegal practices that influenced market movement.122 These illegal practices were caused by a serious lack of awareness and knowledge of securities investment among the majority of investors, as well as the lack of experience of brokerage firms. As a result, these practices led to an unusual rise in market share prices.

Since the early 1970s and up until the early 1980s, Saudi Arabia had an unofficial ‘over the counter’ market for stocks.123 Thus, share prices were unreliable and varied from

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118 This type of competitive advertising in the local press was headed ‘buy and sell shares’.
119 ‘Share allocation’ means the act of spreading a small number of shares among a large number of people who have applied for them. The allocation policy gives priority to small shareholders.
121 Ibid.
122 Examples of irregular practices include: phantom transactions in the sale of shares; selling with the contract open; misleading the public by giving faulty and unrealistic pricing information to the press; having a monopoly on influencing market prices; and broadcasting tendentious rumours to influence the market level.
123 The ‘over the counter’ market is a market operated by security dealers for stocks not listed on the stock exchange. See Nygh and Butt, above n 105, 358. In addition, in 1960s, the OTC market was a large, important and heterogeneous securities market in the US due to the fact that the OTC market was
one broker to another. Hence, a number of irregular secondary markets were created and supported by unlawful practices conducted in the share market.

In summary, it can be clearly seen that during the period 1935–1984, the stock market in Saudi Arabia had significant inadequacies and was characterised by the following:

i. A lack of awareness amongst investors and investment intermediaries;

ii. Viability of the market for illegal practices in the absence of a regulatory framework of the securities market;

iii. The small size of the market in comparison to the volume of shares available for trading between individuals;

iv. The expansion of informal brokerage firms;

v. The complexity of the emerging market compared to a small ‘leaf stalk-sized’ base of the informal brokerage firm, investors and speculators;

vi. The lack of a sense of social responsibility of business coupled with a trend towards an acceptance of profitability by misleading means.

2.4.2 Growth and Development of the Saudi Securities Market 1985–2002

The need to re-evaluate the stock market trading system came as a result of the growing appetite for equity investment, higher share prices and the irregular practices mentioned earlier. In the early 1980s, the government launched a rapid development program, exempted from securities regulations; see Allen Ferrell, 'Mandatory Disclosure and Stock Returns: Evidence from the Over-the-Counter Market' (2007) 36 Journal of Legal Studies 213, 219.
including plans for establishing a formal Saudi stock market. A formal stock market was imperative to protect investors, as well as to sustain the country’s economic growth.

To this end, in 1984, the Saudi government started to organise the market in a planned way, enhancing its regulatory environment and facilitating registration. Accordingly, a formal stock exchange mechanism was established. The function of stock brokerage was restricted to commercial banks.

In 1985, Saudi Share Registration Company (SSRC) was established; and, in 1990, the Electronic Securities and Information System (ESIS), which is an automated information system for stocks, was introduced. Participation in the stock market was restricted to Saudi citizens and Saudi corporations until 1994 when citizens of the Gulf Corporation Council countries (GCC) were allowed to access the market.

In 1997, foreign participation was initially allowed only in the banks’ mutual funds, with the first closed-ended Saudi Mutual Fund (SAIF) introduced by the Saudi American Bank. In 1999, the stock market was opened to foreign investment through a wider range of Saudi banks’ mutual funds. In 2001, the ESIS was replaced with the launch of a new automated system for trading, clearing, and settlement called

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124 In 1984, a Ministerial Committee composed of the Ministry of Finance and National Economy, the Ministry of Commerce, and the Saudi Arabian Monetary Agency (SAMA) was formed to regulate and develop the market.
125 A brokerage monopoly was granted only to Saudi banks. Trading is ‘over the counter’ and is confined to 12 banks.
126 Saudi Share Registration Company (SSRC) was a private limited liability company established to provide central registration facilities for listed companies. It settles and clears all equity transactions. It works as ‘Clearing House’.
127 Electronic Securities and Information System (ESIS) was an electronic floorless share trading and settlement system operated and supervised by SAMA.
129 The Saudi Arabian Investment Fund (SAIF) established in 1997 by the Saudi-American Bank was the first closed-end country mutual fund issued in the market to serve foreign investments in the Saudi stock market. See Ramady, above n 104, 156.
130 Ibid 157.
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

**Tadawul**, which provides continuous order, drives the market and settles transactions in the market. Trading through the internet also began in 2002. The establishment of the Tadawul was the foundation of a new stock market index called the Tadawul All Share Index (TASI), which is currently considered the official Saudi stock market index. Hence, by virtue of its ease, transparency and speed in processing transactions, the system fostered greater market liquidity and increased the volume of trade.

Another development in the stock market was the commencement of the bond market. Government Development Bonds (GDBs) were first offered to domestic banks and several special government agencies in June 1988. Since the government began trading GDBs in the primary market, procedures governing the secondary market have been established by the Saudi Arabian Monetary Agency (SAMA) and primary dealers. For instance, domestic banks play several important roles: as investors, as distribution agents, as secondary market-makers, and as sub-custodians/paying agents.

With respect to stock market growth, the period 1985–2002 experienced an enormous increase in the number of listed companies and resultant market capitalisation. The number of shares traded increased by more than 14,825 per cent during this period, having increased by 151 per cent by the end of 2002 (compared with 2001). The value of shares traded has risen by 9048 per cent during the same period, having

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131 The term *tadawul* is an Arabic word that means ‘exchange’. It is an entity still owned by the banks that formed the brokers’ oligopoly, but is more heavily regulated by SAMA.
increased by 60 per cent by the end of 2002 (compared with 2001).\textsuperscript{135} The market capitalisation of shares issued had risen by 290 per cent by the end of 2002 (compared with 2001).\textsuperscript{136} The general share price index increased to 2311.4, and had increased by 3.62 per cent by the end of 2002 (compared with 2001).\textsuperscript{137}

Development and growth have encompassed all areas of the Saudi economy, including investment funds, which have recorded a great expansion in the value of their investments and in the number of their subscribers (which grew by an annual rate of 20 per cent during the period from 1992 to the end of 2003).\textsuperscript{138} The number of funds floated rose from 52 to 151, and the value of their total investment assets increased from SAR 12.4 billion to SAR 52.23 billion (approximately USD 13.928 billion) over the same period.\textsuperscript{139} According to an official statement by the former governor of SAMA:

\begin{quote}
The stock market has experienced significant growth during the period (1990-2001). The number of shares traded increased 4000 per cent, and the value of shares traded rose up to 1800 percent. The number of people invested in the stock market had reached more than 1.6 million, which is more than about 10 per cent of the citizens, (and the market value of shares issued by the end of the first half of 2002 about 308 billion riyals). At the same time, the mutual funds industry had grown significantly and the average annual growth rate of the number of participants 23 per cent during the period (1992-2001). The number of mutual funds rose from 52 to 138 mutual funds with a rapid increase in the total assets investment from 4.12 billion riyals to 50 billion riyals during that period.\textsuperscript{140}
\end{quote}

It can be said that despite its notable growth, the stock market remained as what could best be described as a government-controlled banking consortium. This was as a result

\begin{footnotesize}
\begin{enumerate}
\item[138] Al-Jarf, above n 133, 8.
\item[139] From the year 1995 through to 2004, rapid growth had been witnessed by the Saudi share market. This growth was supported by the 2001 consolidation of ESIS and the SSRC into the \textit{Tadawul}. See Beach, above n 24, 314.
\end{enumerate}
\end{footnotesize}
of the absence of a securities exchange and independent market makers. It has also been observed that the Saudi stock market was hindered by family business groupings and attitudes, in spite of the attempts in the country to broaden the entrepreneurial class base. In brief, it can be said that during the period 1985–2002, the stock markets were inadequate for a number of reasons. The absence of comprehensive laws for securities markets was a major obstacle for the development of the Saudi stock market. This, combined with the absence of adequate stock market exchange, a lack of market intermediation (that is, too few financial firms standing between the buyer and seller) and, most importantly, the lack of transparency and disclosure creditability, had the effect of hampering further development. Moreover, Akikina and Hoshan in their study found that the lack of well-developed financial markets in the country had another effect: it caused massive private capital outflows from the country. Consequently, it can be clearly said that despite the development that the stock market had witnessed during this period and in spite of the need for domestic investment, the local market was considered to be far behind and the opportunities far fewer than in the overseas capital markets, so there was a significant capital outflow.

142 Akikina and Al-Hoshan in their study state that 'one of the major problems for Saudi Arabia is the huge private capital outflows from the country'. For example, it was estimated that in 1989 Saudi private citizens' investments overseas were as much as USD 60 billion. See Akikina and Al-Hoshan, above n 132, 438.
### Table 2.1: Saudi Stock Market Indicators 1985-2002

<table>
<thead>
<tr>
<th>End of Period</th>
<th>Number of Listed Companies</th>
<th>Number of Shares Traded (Million)</th>
<th>Face Value of Shares Traded (Million SAR)</th>
<th>Number of Transactions (Million)</th>
<th>General Index 1985 = 1000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985&lt;sup&gt;143&lt;/sup&gt;</td>
<td>N/A</td>
<td>4</td>
<td>760</td>
<td>7,842</td>
<td>690.88</td>
</tr>
<tr>
<td>1986</td>
<td>46</td>
<td>5</td>
<td>831</td>
<td>10,833</td>
<td>646.03</td>
</tr>
<tr>
<td>1987</td>
<td>51</td>
<td>12</td>
<td>1,686</td>
<td>23,267</td>
<td>780.64</td>
</tr>
<tr>
<td>1988</td>
<td>52</td>
<td>15</td>
<td>2,037</td>
<td>41,960</td>
<td>892.00</td>
</tr>
<tr>
<td>1989</td>
<td>54</td>
<td>15</td>
<td>3,364</td>
<td>110,030</td>
<td>1,086.00</td>
</tr>
<tr>
<td>1990</td>
<td>57</td>
<td>17</td>
<td>4,403</td>
<td>85,298</td>
<td>979.80</td>
</tr>
<tr>
<td>1991</td>
<td>60</td>
<td>31</td>
<td>8,527</td>
<td>90,559</td>
<td>1,765.24</td>
</tr>
<tr>
<td>1992</td>
<td>60</td>
<td>35</td>
<td>13,699</td>
<td>272,075</td>
<td>1,888.65</td>
</tr>
<tr>
<td>1993</td>
<td>65</td>
<td>60</td>
<td>17,360</td>
<td>319,582</td>
<td>1,888.65</td>
</tr>
<tr>
<td>1994</td>
<td>68</td>
<td>152</td>
<td>24,871</td>
<td>357,180</td>
<td>1,282.90</td>
</tr>
<tr>
<td>1995</td>
<td>69</td>
<td>117</td>
<td>23,227</td>
<td>291,742</td>
<td>1,367.60</td>
</tr>
<tr>
<td>1996</td>
<td>70</td>
<td>138</td>
<td>25,397</td>
<td>283,759</td>
<td>1,531.00</td>
</tr>
<tr>
<td>1997</td>
<td>70</td>
<td>312</td>
<td>62,060</td>
<td>460,056</td>
<td>1,957.80</td>
</tr>
<tr>
<td>1998</td>
<td>74</td>
<td>293</td>
<td>51,510</td>
<td>376,617</td>
<td>1,413.10</td>
</tr>
<tr>
<td>1999</td>
<td>73</td>
<td>528</td>
<td>56,578</td>
<td>438,226</td>
<td>2,028.53</td>
</tr>
<tr>
<td>2000</td>
<td>75</td>
<td>555</td>
<td>65,292</td>
<td>498,135</td>
<td>2,258.29</td>
</tr>
<tr>
<td>2001</td>
<td>76</td>
<td>691</td>
<td>83,602</td>
<td>605,035</td>
<td>2,430.11</td>
</tr>
<tr>
<td>2002&lt;sup&gt;144&lt;/sup&gt;</td>
<td>68</td>
<td>1,736</td>
<td>133,787</td>
<td>1,033,669</td>
<td>2,518.08</td>
</tr>
</tbody>
</table>


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<sup>143</sup> The first year that data was available for the Saudi stock market.

<sup>144</sup> The number of listed companies decreased as a result of a merger between the electricity companies into a single company.
Table 2.2: Market Capitalisation and Market Size of the Saudi Stock Market for the Period 1985–2002

<table>
<thead>
<tr>
<th>End of Period</th>
<th>Market Capitalisation (MC) (Billion Riyals)</th>
<th>Market Size (Depth) (%) (1) ÷ (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>67.00</td>
<td>18</td>
</tr>
<tr>
<td>1993</td>
<td>197.90</td>
<td>41</td>
</tr>
<tr>
<td>1994</td>
<td>145.10</td>
<td>29</td>
</tr>
<tr>
<td>1995</td>
<td>153.39</td>
<td>29</td>
</tr>
<tr>
<td>1996</td>
<td>171.98</td>
<td>30</td>
</tr>
<tr>
<td>1997</td>
<td>222.70</td>
<td>37</td>
</tr>
<tr>
<td>1998</td>
<td>159.91</td>
<td>30</td>
</tr>
<tr>
<td>1999</td>
<td>228.59</td>
<td>38</td>
</tr>
<tr>
<td>2000</td>
<td>254.46</td>
<td>37</td>
</tr>
<tr>
<td>2001</td>
<td>274.53</td>
<td>40</td>
</tr>
<tr>
<td>2002</td>
<td>280.73</td>
<td>40</td>
</tr>
</tbody>
</table>


2.4.3 Saudi Securities Market Development 2003–2011

The ongoing growth of the Saudi stock market demanded additional reforms to be adopted by the Saudi government in order to keep pace with the stock market development. Therefore, the first securities law, the Capital Market Law (CML’03), came into existence in 2003 and created the first securities regulatory body, the Capital Market Authority (CMA), to oversee the stock market.
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

The new law established an independent financial market regulator, the CMA. It is the sole regulator of the stock market in Saudi Arabia.\(^{145}\) The proclamation of the CML’03 in mid-2003 and the subsequent establishment of the CMA in mid-2004 as the primary regulatory authority for the Saudi capital market and the operation of stock exchange have been internationally recognised as positive measures by the market as a whole, both by investors and by market intermediaries.\(^{146}\) In addition, the CML’03 established the first national securities depository centre, which was later incorporated into the Securities Exchange. The exchange will be a private sector company.\(^{147}\) With the purpose of being in line with global stock market operations, the Saudi Capital Market Company (SCMC), with a capital of SAR 1.2 billion (USD 320 million), was established by the Saudi government. The SCMC converted the Tadawul into a joint stock company fully owned by the Public Investment Fund. The SCMC provides a formal stock exchange.

With respect to the stock market growth, the year 2003 experienced a significant increase comparing with the last year of the previous period from 1985 to 2002. The number of shares traded increased by 221 per cent by the end of 2003 (compared with 2002).\(^{148}\) The value of shares traded increased by 346 per cent at the end of 2003.

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\(^{145}\) On 31 July 2003, the Capital Market Authority (CMA) was established pursuant to the Capital Market Law 2003. The CMA represents the government apparatus which is mainly entrusted with the management and organisation of the Saudi Capital Market, and which reports directly to the chairman of the Council of Ministers. The CMA will be thoroughly discussed in the next chapter, ‘Legal and Regulatory Framework of the Securities Market in Saudi Arabia’.


\(^{147}\) ‘Securities Exchange’ will be described in the next chapter ‘Legal and Regulatory Framework of the Securities Market in Saudi Arabia’.

(compared with 2002).\textsuperscript{149} The market capitalisation of shares issued had risen by a further 110.14 per cent by the end of 2003 (compared with 2002).\textsuperscript{150} The general share price index increased to a further 76.23 per cent by the end of 2003 (compared with 2002).\textsuperscript{151} Over 1.6 million individuals had invested in the shares of Saudi joint-stock companies by the end of 2003.\textsuperscript{152}

In the past decade, the economy of Saudi Arabia has witnessed major reforms, the vast majority of which were due to the government adoption of a privatisation policy.\textsuperscript{153} In November 2002, Saudi Arabia announced plans to privatise 20 major public corporations or services. As a first step, Saudi Telecom has been partially privatised and its initial public offering (IPO) was oversubscribed and those fortunate enough to buy the shares made a large profit instantly if they chose to realise their investments.

In August 2008, for the purpose of adding depth for market participants, foreign institutional investors were also allowed to participate in share trading under specific rules put in place by the CMA.\textsuperscript{154} In March 2010, the CMA announced that it had arranged the commencement of its first Exchange-Traded Fund (ETF) and would allow non-resident foreign investors to trade in it. Nevertheless, foreign portfolio investment has not yet been permitted in the Saudi stock market.

\textsuperscript{150} Ibid.
\textsuperscript{152} Al-Jarf, above n 133, 8.
\textsuperscript{154} The CMA issued Circular No. 2-28-2008 on 18 August 2008 (08/17/1429) (the Circular), allowing foreign investors to execute, under certain terms and conditions, equity swap agreements in respect of listed Saudi Shares. The circular permits only CMA Authorised Persons to enter into Swap Agreements. For example, see Morgan Stanley, 'Morgan Stanley Saudi Arabia Executed First Equity Swap Agreement in the Kingdom' (Press Release, 25 August 2008) <http://www.morganstanley.com/about/press/articles/6849.html>.
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

On 23 January 2012, Saudi Arabia’s Capital Market Authority announced an amendment to its listing regulations. The new rules allow a foreign issuer whose securities are listed in another regulated exchange to apply for its securities to be registered and admitted to listing on the Saudi Arabian exchange. Article 14 of the CMA Listing Rules 2004 (LR’04) provides the conditions relating to cross listing by stating that:

a. A foreign issuer whose securities are listed in another regulated exchange may apply for its securities to be registered and admitted to listing on the Exchange. The Authority may admit the securities to listing provided that, in the Authority’s opinion, the listing rules applicable in the foreign issuer’s jurisdiction of listing are at least equivalent to these Rules.

By December 2009, the number of listed companies had increased to 134, with a share capital of SAR 596 billion (USD 158.9 billion). Meanwhile, the number of registered joint stock companies had risen to 400 with SAR 470.2 billion (USD 125.4 billion) share capital, and the number of limited liability and joint venture companies had climbed to 16,908, with a combined SAR 155.6 billion (USD 41.5 billion) in share capital. Consequently, it can be clearly seen that regardless of the higher number of listed companies since 2002, a need persists for more listed companies to strengthen the current stock market. Several Saudi stock market analysts claim that the slow pace of Initial Public Offerings (IPOs) and listing is due to the Saudi listing requirements imposed by the regulator being burdensome. For example, the CMA is planning to impose further requirement and conditions on the new public offers in order to prevent

weak companies from entering the stock market. However, this will generally delay the IPO market development.

Furthermore, although the Saudi stock market is large compared to the markets of other developing countries, recent studies have found that, like those of most developing countries, it is not efficient when looking at the growing economy of the country and the listed firms in the securities market. The number of companies listed in the Saudi stock market is small when compared with the total number of the non-listed companies able to go public. Research carried out in 2003 among the top 1000 Saudi non-listed companies revealed that around 137 new companies could be listed in the Saudi securities exchange based on the current requirements. Indeed, this would substantially increase market capitalisation and therefore strengthen the market.

In today’s international economic market, the mutual fund sector has played a large and important role in the financial and capital markets. In the Saudi Arabian market, stock market growth was fostered by significant growth in the Saudi mutual fund segment, which rose to a peak of SAR 137 billion (USD 36.5 billion) in 2005.

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159 Ramady, above n 104, 156.
160 Ibid 171.
Table 2.3: Saudi Stock Market Indicators 2003–2011

<table>
<thead>
<tr>
<th>End of Period</th>
<th>Number of Listed Companies</th>
<th>Number of Shares Traded (Million)</th>
<th>Face Value of Shares Traded (Million SAR)</th>
<th>Number of Transactions</th>
<th>General Index 1985=1000</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>70</td>
<td>5,566</td>
<td>596.51</td>
<td>3,763.40</td>
<td>4,437.58</td>
</tr>
<tr>
<td>2004</td>
<td>73</td>
<td>10,295</td>
<td>1,773.86</td>
<td>13,319.52</td>
<td>8,206.23</td>
</tr>
<tr>
<td>2005</td>
<td>77</td>
<td>12,281</td>
<td>4,138.70</td>
<td>46,607.95</td>
<td>16,712.64</td>
</tr>
<tr>
<td>2006</td>
<td>86</td>
<td>68,515(^{161})</td>
<td>5,261.85</td>
<td>96,095.92</td>
<td>7,933.29</td>
</tr>
<tr>
<td>2007</td>
<td>111</td>
<td>57,829</td>
<td>2,557.71</td>
<td>65,665.50</td>
<td>11,038.66</td>
</tr>
<tr>
<td>2008</td>
<td>127</td>
<td>58,727</td>
<td>1,962.95</td>
<td>52,135.93</td>
<td>4,802.99</td>
</tr>
<tr>
<td>2009</td>
<td>135</td>
<td>56,685</td>
<td>1,264.01</td>
<td>36,458.33</td>
<td>6,121.76</td>
</tr>
<tr>
<td>2010</td>
<td>146</td>
<td>33,007</td>
<td>759.18</td>
<td>19,536.14</td>
<td>6,620.75</td>
</tr>
<tr>
<td>2011</td>
<td>150</td>
<td>48,535</td>
<td>1,098.83</td>
<td>25,550.00</td>
<td>6,417.73</td>
</tr>
</tbody>
</table>

\(^{161}\) This large increase is due to the split nominal values of the company’s shares to 10 Riyals per share instead of 50 Riyals.
Table 3.4: Market Capitalisation and Market Size of the Saudi Stock Market 2003–2011

<table>
<thead>
<tr>
<th>End of Period</th>
<th>Market Capitalisation (MC) (Billion Riyals)</th>
<th>Market Size (Depth) (%) (1) ÷ (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>589.93</td>
<td>74</td>
</tr>
<tr>
<td>2004</td>
<td>1,148.60</td>
<td>124</td>
</tr>
<tr>
<td>2005</td>
<td>2,438.20</td>
<td>208</td>
</tr>
<tr>
<td>2006</td>
<td>1,225.86</td>
<td>93</td>
</tr>
<tr>
<td>2007</td>
<td>1,946.35</td>
<td>136</td>
</tr>
<tr>
<td>2008</td>
<td>924.53</td>
<td>52</td>
</tr>
<tr>
<td>2009</td>
<td>1,195.51</td>
<td>86</td>
</tr>
<tr>
<td>2010</td>
<td>1,325.39</td>
<td>81</td>
</tr>
<tr>
<td>2011</td>
<td>1,270.84</td>
<td>N/A</td>
</tr>
</tbody>
</table>


2.4.3.1 The 2006 Historical Market Crash

The size of the Saudi stock market was expanding, with market capitalisation having increased by 108 per cent when figures for 2003 and early 2006 are compared, and the volume of traded shares risen by 988 per cent for the same period. However, the boom in the stock market came to a crash in February 2006, causing a loss of 50 per cent of the total market value.

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In February 2006, the Saudi market index (TASI) lost over 13,000 points. It fell from 20,635 to about 6400 points (falling 65 per cent from its highest point). As a result, the country lost SAR 2 trillion (USD 533 billion) of its national wealth. The savings and investments of Saudi citizens were devastated.

Consequently, thousands of stock market investors lost substantial amounts of their personal wealth, and a large majority of them accumulated some degree of financial debt. This disaster had an effect on a large proportion of the population, and in several cases, deaths were recorded, and there were other instances where people became ill due to the stress of the situation. It had been the first such crash in the history of Saudi

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Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

stocks. As there was no sudden event leading to this heavy decline in the share prices, studies are now warranted to investigate this issue more thoroughly.167

According to the CMA chairman, Abdulrahman A Al-Twajry, the 2006 collapse was a consequence of the huge increase on the demand side (buying), due in no small part to ordinary people becoming increasingly aware of the opportunities offered by stock market investments and entering the market to invest their savings, which led the share prices to boom until they inevitably collapsed.168 He also claims that the responsibility for the Saudi stock market crisis is shared by three parties: the government, which failed to act in a timely manner and also failed to educate new investors; the media, whose ill-informed commentators continued to encourage people to invest long after it was wise not to do so; and the traders themselves, who were criticised for failing to research the market, and invested on the advice of friends and families rather than from a considered perspective, or without any expert advice.169

As the majority of market participants suffered a loss from their investments, this led to questions being asked in relation to the integrity of the stock market and calls for governmental intervention and better control of market dynamics. The investors’ main concern was related to the ability of large investors and insiders to access private information to gain unfair advantage.170 Weak transparency coupled with inadequate disclosure requirements do undermine stock market development. Hence, it can be suggested that the existence of a robust disclosure regime could be crucial to stock

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167 As it was noted in the introductory chapter, the 2006 huge market crash is one of the motivations of this study.
169 Ibid 8.
market integrity. In addition, it will provide protection for market participants, which will consolidate confidence amongst investors.\textsuperscript{171}

2.4.4 Comparative Position of the Saudi Securities Market amongst Its Regional and International Counterparts

In 1996, the stock market in Saudi Arabia was ranked as the 13\textsuperscript{th} largest developing market and the largest in the GCC region,\textsuperscript{172} with market capitalisation of SAR 172 billion (USD 45.9 billion), 740 million shares issued and 1.67 million individual shareholders.\textsuperscript{173} In 2000, its position had further improved: the Saudi market became the largest in the region, ‘accounting for about 50\% of the six GCC stock markets, making up one third of the Arab countries’ stock markets, and being 11\textsuperscript{th} among the emerging markets’.\textsuperscript{174}

According to a study on GCC stock markets carried out between 2002 and 2004, ‘Saudi Arabia clearly dominates GCC stock market activities and constitutes the bulk of GCC market capitalisation’.\textsuperscript{175} The same study states that:

[B]y far the largest stock market is Saudi Arabia, with a market capitalization of USD 237.1 billion at the end of 2004. An average daily trading volume of USD 1.93 billion also makes Saudi Arabia the most active of the GCC stock markets.\textsuperscript{176}

A recent empirical study of eight Arab Middle Eastern countries found that the stock market of Saudi Arabia has shown a steady improvement in its efficiency since mid-
Moreover, a recent report released by the Arab Monetary Fund (AMF) points out that the total market value of Arab securities markets increased by 17.4 per cent to about USD 903.4 billion by the end of the year 2009. Indeed, by the end of 2009 the value of the Saudi stock market comprised 35.3 per cent of the total market value of Arab stock markets, and the value of shares traded on the Saudi stock market was USD 337.1 billion, representing 51.6 per cent of the total value of shares traded on the markets of Arab countries. During 2009, the Saudi stock market recorded the highest indicators of all Arab stock markets; the market value of the Saudi stock market rose to USD 318.8 billion.

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178 The Arab Monetary Fund is a Regional Arab Organisation. Founded in 1976, it started operations the following year. Member countries (22) are: Jordan, the United Arab Emirates, Bahrain, Tunisia, Algeria, Djibouti, Saudi Arabia, Sudan, Syria, Somalia, Iraq, Oman, Palestine, Qatar, Kuwait, Lebanon, Libya, Egypt, Morocco, Mauritania, Yemen, and Comoros. For more details, see Arab Monetary Fund, Objectives and Means (29 August 2011) <http://www.amf.org.ae/content/objectives-and-means>.


Table 2.5: GCC and Arab Stock Markets Indicators at the End of 2010

<table>
<thead>
<tr>
<th>Rank</th>
<th>Market</th>
<th>Market Capitalisation (USD millions)</th>
<th>Value of Shares Traded (USD millions)</th>
<th>Number of Listed Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Saudi Arabia</td>
<td>353,400.0</td>
<td>202,432.0</td>
<td>146</td>
</tr>
<tr>
<td>2</td>
<td>Qatar</td>
<td>123,641.0</td>
<td>18,453.0</td>
<td>43</td>
</tr>
<tr>
<td>3</td>
<td>Kuwait</td>
<td>113,883.0</td>
<td>43,777.0</td>
<td>214</td>
</tr>
<tr>
<td>4</td>
<td>Abu Dhabi</td>
<td>77,081.0</td>
<td>8,986.0</td>
<td>64</td>
</tr>
<tr>
<td>5</td>
<td>Morocco</td>
<td>69,386.0</td>
<td>13,881.0</td>
<td>75</td>
</tr>
<tr>
<td>6</td>
<td>Egypt</td>
<td>84,109.0</td>
<td>57,560.0</td>
<td>212</td>
</tr>
<tr>
<td>7</td>
<td>Dubai</td>
<td>54,692.0</td>
<td>16,075.0</td>
<td>65</td>
</tr>
<tr>
<td>8</td>
<td>Jordan</td>
<td>30,904.0</td>
<td>9,490.0</td>
<td>277</td>
</tr>
<tr>
<td>9</td>
<td>Oman</td>
<td>28,309.0</td>
<td>3,422.0</td>
<td>119</td>
</tr>
<tr>
<td>10</td>
<td>Bahrain</td>
<td>20,060.0</td>
<td>289.0</td>
<td>49</td>
</tr>
<tr>
<td>11</td>
<td>Lebanon</td>
<td>12,676.0</td>
<td>1,871.0</td>
<td>26</td>
</tr>
<tr>
<td>12</td>
<td>Tunisia</td>
<td>10,612.0</td>
<td>1,871.0</td>
<td>56</td>
</tr>
<tr>
<td>13</td>
<td>Sudan</td>
<td>2,446.0</td>
<td>1,018.0</td>
<td>53</td>
</tr>
<tr>
<td>14</td>
<td>Palestine</td>
<td>2,449.0</td>
<td>468.0</td>
<td>40</td>
</tr>
<tr>
<td>15</td>
<td>Algeria</td>
<td>106.0</td>
<td>161.5</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Saudi Arabian Monetary Agency, 47th Annual Report.\(^{180}\)

In 2010, a comparison of selected Arab share market indicators revealed that the Saudi stock market recorded the highest indicators of all Arab stock markets. Market capitalisation of the Saudi stock market stood at USD 353.4 billion, compared to an

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average of USD 65.6 billion for the Arab countries.\textsuperscript{181} Market capitalisation of the Saudi stock market represented 35.9 per cent of total market capitalisation of Arab securities markets by the end of 2010.\textsuperscript{182}

Despite Saudi Arabia having one of the largest markets in the region, the number of listed companies is relatively small in comparison with some of the emerging markets elsewhere in the world. In terms of the number of listed companies, some of the emerging markets — such as India, Korea and China — have many times the number of companies listed in Saudi Arabia. Nevertheless, in 2003 the Saudi stock market became the ninth largest emerging market in terms of the value of shares listed in the market. In 2005, the Saudi stock market, with a capitalisation of USD 518 billion, was ranked second amongst the largest emerging markets and 12\textsuperscript{th} largest worldwide.\textsuperscript{183} For example, in 2004–2005, Saudi Arabia’s stock exchange had a market capitalisation larger than that of South Korea.\textsuperscript{184}

A study in 2006 showed the Saudi market to be the largest market in the region, with a market capital of SAR 1.6 trillion (USD 418 billion), and the market remained the largest amongst its regional counterparts until 2012, with a market capital of SAR 1.4 trillion (USD 373 billion).\textsuperscript{185} The study also showed that the average daily trading was
more than SAR 15 billion (USD 4 billion), the average of which is 49 times the value of the daily trading in 2001, which did not exceed SAR 304 million (USD 81 million). The same study added that the Saudi stock market represents from 60 to 70 per cent of the financial markets in the region in terms of market capitalisation and activity. In addition, the development in the Saudi mutual fund sector has been remarkable, given that ‘the Saudi mutual fund market has been impressive and today Saudi Arabia has the largest mutual fund industry in the Arab world’.  

Based on the above, it can be clearly seen that since its inception, the Saudi stock market has experienced significant growth in terms of stock market size, volume and value of trade. However, it is argued that the supposed potential development of the stock market is yet to be achieved. The following section will discuss shortcomings associated with the development of the Saudi stock market.

2.5 General Drawbacks of the Development of the Saudi Securities Market

The relationship between stock market development and economic growth is imbalanced in Saudi Arabia. Compared to the country’s economy, the stock market does not reflect the real growth in the country. An empirical study found that well-developed stock markets can foster economic growth in the long run. While the Saudi stock market has become the leader amongst Middle Eastern and Arab nations, the...
market is still classified as an inefficient market. Based on Standard and Poor’s Emerging Markets Data Base (EMDB), the Saudi stock market remains as an emerging market belonging to the Middle East and North Africa region. Several studies tested the efficiency of the Saudi stock market. The majority of these studies have classified the Saudi stock market as an inefficient market. A study carried out by Butler and Malaikah found that the Saudi stock market was considered as an inefficient market. Al-Razeen examined the efficiency of the Saudi stock market for the period 1992–1995. He found that the market has a low level of efficiency and classified it as a ‘weak form’ in terms of market efficiency.

According to the Financial Times Stock Exchange (FTSE) quality of markets criteria of 2012, the Saudi stock market remains suffering from:

i. significant government ownership of listed companies,

ii. relatively low institutional ownership,

iii. limited number of brokerage firms publishing analysts recommendations and none publishing analysis forecasts,

iv. prohibition of short sales in all markets,

v. unavailability of derivatives for trading in all markets, and

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188 Al-Ajmi and Kim, above n 11, 1746.
192 For further details about the FTSE, see FTSE Group, Quality of Markets Criteria (Middle East) (March 2012) <http://www.ftse.com/Indices/Country_Classification/Downloads/March%202012%20Update%20and%20Matrices/Middle_East_Matrix_March_2012.pdf>.
vi. failure to match international standards although all markets have taken a number of measures to improve the transparency, disclosure level and corporate governance requirements.

In addition, the Saudi securities market still suffers from a high percentage of individuals who are trading directly in the market without investing through institutional investors. Individual investors account for more than 92 per cent of trading transactions in Saudi Arabia and their investment decisions are not based on experience in securities market.\(^{193}\) In fact, this may harm the market as well as the investors.

These drawbacks have had a negative impact on the development of the Saudi stock market. Moreover, these and other factors inhibit the potential growth of the market. These are: the small number of listed companies, the instability of the market, and the absence of foreign portfolio investment.

### 2.5.1 The Small Number of Listed companies

The number of listed companies in Saudi Arabia is low by international or regional standards. More importantly, the number of listed companies is low in relation to the size of the Saudi economy, which has been a major shortcoming of the Saudi stock market. In 2002, there were 68 listed companies with SAR 38 billion (USD 10.1 billion) share capital, and 121 registered joint stock companies with SAR 81.3 billion (USD 21.2 billion) share capital.\(^{194}\) There were another 6000 limited liability Saudi companies operating in the country and a further 1400 joint venture companies (national and

\(^{193}\) Abdulslam Albalawi, 'Shura Criticises the Capital Market Authority', *Alriyadh* (online), 5 November 2012 <http://www.alriyadh.com/2012/11/05/article781714.html> [Arabic].

foreign), with a combined share capital of SAR 85.5 billion (USD 22.8 billion). All these companies remain outside the stock market.

Recently, a commentator pointed out that, ‘although the Saudi stock market is the largest stock market in the Middle East, representing 41 per cent of the total capitalisation of Arab stock exchanges, the number of listed stocks and the size of the free float of shares is small’.  

Currently, Table 2.6 (below) shows that the number of joint stock companies by 2010 was 882 companies, 150 of which were listed in the Saudi stock market, which implies that more than 75 per cent of the existing joint stock companies were not included in the Saudi stock market. This shows that the Saudi authorities have a challenging task ahead to attract new companies to be listed in the market.

Table 2.6: Companies by Type of Capital in Saudi Arabia 2010

<table>
<thead>
<tr>
<th>Type of company</th>
<th>Number</th>
<th>Capital (Million Riyals)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint stock companies</td>
<td>882</td>
<td>632,396.8</td>
</tr>
<tr>
<td>Limited liability partnerships</td>
<td>15,570</td>
<td>205,781.6</td>
</tr>
<tr>
<td>Joint liability partnerships</td>
<td>3,328</td>
<td>3,799.2</td>
</tr>
<tr>
<td>Mixed liability partnerships</td>
<td>1,345</td>
<td>8,889.5</td>
</tr>
<tr>
<td>Mixed liability partnerships by shares</td>
<td>5</td>
<td>2.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21,130</strong></td>
<td><strong>850,870.0</strong></td>
</tr>
</tbody>
</table>


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195 Alzahrani and Skerratt, above n 39.
196 See also Saudi Stock Market Indicators, above Table 2.3.
Furthermore, many listed firms are small compared to the top Saudi companies. For instance, the top six Saudi listed firms (Saudi Basic Industries Corp, Saudi Telecom Co, Saudi Electricity Co, Al Rajhi Banking and Investment Corp, Saudi American Bank, and Riyad Bank) represent about 71 per cent of total Saudi market capitalisation. The government owns a large portion of companies traded. Family ownership is also evident in many firms.

2.5.2 Instability of the Market

The performance of Saudi stock market is unstable. There are two issues which are believed to be the major causes of the unsteady market. The first is the unprecedented securities market crash in 2006 and its continuing effects on investors. The volatility continues in stock prices and it has a negative impact on investor confidence in the stock market. This issue was evident after the 2006 market collapse, which badly affected investors in the market. Following this unprecedented crash, investors fled the market and potential investors preferred not to invest in the exchange. As a result, trading volume has significantly decreased and the market has been suffering from a low inflow of funds into the exchange.

A number of Saudi economists recently announced that the crisis of investor confidence in the stock market persists and that it has resulted in weaker market. They agreed that market volatility is the major cause of reduced investor confidence. Another commentator declared that ‘the Saudi stock market is suffering from a loss of

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199 Ibid.
confidence among investors which desperately needs to be restored’. A recent study on the Middle Eastern capital markets found that the most influential factor in investment decisions is confidence, which is necessary in order for an investor to put his or her capital at risk. Thus, it can be said that the negative effects of the loss of investor confidence have affected the development of the Saudi stock market.

The second factor is the correlation between the oil prices and the stock market in Saudi Arabia. As the country’s economy fully relies on oil production, the stock market is highly affected by oil prices. For that reason, there is a significant correlation between oil prices and the stock market. A recent empirical study on the effect of oil prices on the GCC countries found that there is a positive linkage between oil prices changes and the stock markets in Qatar, the UAE and Saudi Arabia.

The SAMA Annual Report of 2006 declared that the significant increase in oil prices was one of the major factors that led to the strong performance of the Saudi stock market from 2003 to 2005. Recent research undertaken by Alshogeathri affirms that ‘the strongest influence on Saudi stock market returns variation was the price of oil’.

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202 Saudi economy is commonly considered a small open oil-based economy. In fact, oil revenue represents about 80–90% of total export earnings, which account for more than 75% of the government’s annual budget. See Nimrod Raphaeli, 'Saudi Arabia: A Brief Guide to Its Politics and Problems' (2003) 7 Middle East Review of International Affairs 21, 22.
Indeed, improvements in the non-oil sector are essential to protect the stock market from oil prices shocks. It was suggested that the high dependence on oil is considered as a major challenge for the country’s economy.\(^{205}\) In addition, the significant relationship between oil prices and stock markets may harm the actual performance and development of the stock market in Saudi Arabia. A study carried out in 2011 by a number of scholars found that the close relationship between oil prices and the stock market would imply some degree of predictability in the stock markets and is a source of volatility,\(^{206}\) which is unrelated to the underlying strength of the individual company but reflecting anticipatory rises and falls according to oil price fluctuations. In fact, the country’s economy needs to lessen its dependence on oil production and find alternative sources to strengthen the economy. This view is echoed by the current Petroleum Minister, who has recently admitted that ‘it is inappropriate to rely on oil production as a basis for national income’.\(^{207}\)

### 2.5.3 The Absence of Foreign Portfolio Investment

Currently, foreign portfolio investment is not available in Saudi Arabia for both institutions or individuals.\(^{208}\) The Saudi stock market is not yet fully open to foreign portfolio investment. Foreign investors from outside the country must enter into swap foreign investment agreements or hold mutual funds that are offered by commercial banks. At present, non-resident foreign and resident foreign investment levels have been

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\(^{206}\) Arouri, Bellalah and Nguyen, above n 203, 101.


\(^{208}\) Foreign portfolio investment is when funds enter a country to invest in the country’s securities. In economics, it is also called ‘foreign indirect investment’ as opposed to the ‘foreign direct investment’ which is setting a new business or investment directly into production. This type of investment does not work through custodian banks.
weak ever since the market was opened to them. For example, the Saudi stock exchange (Tadawul) announced that at the end of 2011:

The percentage share of foreign residents in Saudi Arabia from the market trades was 0.2% for selling and 0.2% for buying. The percentage share of foreigners via swap agreement from the market trades was 1.0% for selling and 0.7% for buying.\(^\text{209}\)

As a result, the correlation between the Saudi stock market and international markets is weak.\(^\text{210}\) In addition, it may be the case that, as mentioned before, family ownership constitutes 70 per cent of the volume of existing firms within the Saudi economy. Thus, it was suggested that ‘some careful development, regulation enforcement and progress are necessary to improve the current system in order to attract further foreign investment to the country’.\(^\text{211}\) Omran and Bolbol, in their empirical research, admitted that developing the stock market is not an easy task because it depends on regulatory capacity, legal history, the existence of an investment culture and the ownership structure of firms.\(^\text{212}\) Allowing foreign portfolio investment has become imperative in order for the Saudi stock market to improve the national economy. Experts in Saudi economics have recently called for allowing foreign funds to enter the Saudi market.\(^\text{213}\) They believe that it will improve the position of the Saudi stock market amongst its

\(^{209}\) Saudi Stock Exchange (Tadawul), Trading Statistic Report According to the Investors Nationality and Type (3 December 2011) <http://www.tadawul.com.sa/wps/portal?ut/p/c0/04_SB8KxLLM9MSzPy8xBz9CP0os3g_A-ewI8TIwN_D38LA09vV7NQP8cQQ3dnA_3g1Dz9gmxHRQBe6u5m/?x=1&PRESS_REL_NO=2851>

\(^{210}\) Alshogeathri, above n 204, 39.


regional and international counterparts and contribute to the creation of a mature market.\textsuperscript{214}

To this end, the regulator should seriously consider the practical steps needed to allow foreign portfolio investment. Foreign funds have become vital, especially, with low trading volumes after local retail investors were hit first by the 2006 market correction, and then by the Global Financial Crisis (GFC) in 2008.

However, while the CMA has announced on several occasions that the market will be opened to indirect foreign investment in the future, nevertheless, it has not yet taken practical steps to achieve this goal, such as issuing rules to regulate the foreign portfolio investment.

2. 6 The Reasons for Weak Investor Protection and its Effects on the Development of the Saudi Securities Market

Weak investor protection has inhibited the development of the Saudi securities market. As discussed earlier, the 2006 market collapse shook public confidence in the securities market. The economy ultimately suffers because the allocation of capital and corporate financing has become inadequate to support growth. Investors in the Saudi securities market are not protected from a lack of information disclosure and this is exacerbated by the weak civil liability regime for breaches of the disclosure regime.

2.6.1 Lack of Transparency and Disclosure

Lack of transparency and failures in information disclosure have been a major problem in the Saudi stock market. Hence, the efficiency of the market has been negatively affected. In addition, investors have lost their confidence in the market. Alkholifey used

\textsuperscript{214} Ibid.
a number of empirical tests, the results of which showed that the Saudi stock market is not efficient with regard to information provided.\textsuperscript{215} Information efficiency is an economic term, which means that the ‘market’s capacity to generate prices for its products that incorporate all information available to the public’.\textsuperscript{216}

Alajlan finds that although the Saudi stock market is one of the most rapidly developing markets in the Middle East and Asia, it presently lacks sound frameworks for regulation, transparency and the disclosure of financial information, all of which are essential for the development of any securities market.\textsuperscript{217}

A survey conducted amongst the investors in Asser Province (the southern region of Saudi Arabia) found that the lack of transparency has led to the loss of confidence amongst the ordinary investors in the market.\textsuperscript{218} As a result, investors have largely abandoned investment in the market.\textsuperscript{219} Certainly, the standards of transparency and governance are still far from ideal. A report by a Saudi analyst states that:

\begin{quote}
The Saudi market has the potential to be not only the largest in the region but also the most liquid and mature. Hopefully, the progressive involvement of international institutions will drive forward transparency and governance in the Kingdom.\textsuperscript{220}
\end{quote}

For example, a recent empirical study found that capital markets in low disclosure countries are more volatile than those in high disclosure countries.\textsuperscript{221}

\begin{footnotes}
\item[217] Alajlan, above n 211, 183.
\item[218] Hossam Abu To'eima, 'The Role of Transparency of Information to Restore Confidence of Small Investors in the Saudi Stock market' (Paper presented at Saudi Stock Exchange Future Prospective Conference, King Khalid University, 13–14 November 2007).
\item[219] Ibid.
\item[220] Grant Thornton International Ltd, above n 165.
\end{footnotes}
As protecting investors is the main objective of securities regulation as set out by the International Organisation of Securities Commissions ( IOSCO), the role of securities regulators becomes more evident in creating such protection by issuing effective rules and regulations to maintain transparency in the market. It is submitted that ‘regulations should view the information efficiency of markets is a goal that they must strive to achieve.’

Therefore, a lack of transparency is one of the main drawbacks from which the Saudi stock market suffers and reforms in this regard are imperative as will be discussed in the following chapter.

2.6.2 Weak Civil Liability for Defective Disclosures and the Development of the Securities Market in Saudi Arabia

The weak civil liability regime for defective disclosures in Saudi Arabia undermines the investor protection which requires an effective and operative liability regime.

Adequate regulations will restore long-term confidence among investors. As shown in the previous chapter, the function of civil liability is two-fold: first, to facilitate compensation for investors who sustain loss or damage resulting from disclosure violation; and second, to deter potential wrongdoers from violating the disclosure regime. Accordingly, a strong civil liability regime will produce a transparent market, compliant companies and investor confidence. This shows that civil liability for defective disclosures has an important role in the development of the securities market. Civil liability is an effective tool that provides investor protection so investors do not abandon the stock market and invest in other sectors. Moreover, Fox suggests that the

222 Zufferey and Tschanz-Norton, above n 216, 140.
mandatory disclosure civil liability system should improve corporate governance, enhance liquidity and create strong incentives to comply at all times.\textsuperscript{223}

The securities regulatory body has a statutory duty to develop the market.\textsuperscript{224} The CMA, as the sole regulatory body for the securities market in Saudi Arabia, must aim to promote stability and liquidity in the market by introducing regulations that encourage investment and reduce risks in the market.\textsuperscript{225} In addition, Principle 6 of the IOSCO statement of Objectives and Principles of Securities Regulation stipulates that ‘[t]he regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.’\textsuperscript{226} A commentator criticised the inadequate role played by the CMA in developing the market as he wrote that ‘the CMA has not made a single modification or introduced any fundamental regulations in the stock market which will foster the financial and monetary policies to encourage people to enter the stock market again’.\textsuperscript{227}

So far, the CMA remains ‘in denial’ and resists efforts for reform, not realising that they are themselves preventing a stock market recovery to the level that existed before the 2006 debacle. In order to restore investor confidence, strengthening of investor protection is essential. A recent study conducted on a number of African stock markets suggests that stock market development should be encouraged through appropriate legal

\textsuperscript{224} Capital Market Law 2003 (Saudi Arabia) art 5(a)(1).
\textsuperscript{225} Ibid.
\textsuperscript{226} IOSCO, 'Objectives and Principles of Securities Regulation-2010', above n 18, 4.
\textsuperscript{227} Sami Al-Nwaisir, 'Where is the Saudi Stock Market Heading?', Arab News (online), 29 February 2012 <http://www.gulfbase.com/newarticles/specialarticledetail/2555>.
and regulatory policies to remove barriers to market operation and thus enhance their efficiency.  

Hence, a central concern of this thesis is to suggest the protection of investors by strengthening the disclosure regime, enforcing securities laws and, most importantly, facilitating civil liability for investors aggrieved because of a violation of the disclosure regime.

2. 7 The Meaning of Concepts and Terms

2.7.1 Securities

In finance, a ‘security’ is a financial instrument that proves the ownership of an investment and represents a financial value. So far, the term ‘security’ has not had a precise and single legal definition. The definition of the term ‘security’ varies from one jurisdiction to another. Generally, a security is a ‘financial asset’ issued by business entities or governmental bodies for the purpose of raising funds for business or for borrowing money for the government from the public. Arnett says, ‘a security is simply a manifestation of a promise by an issuer to pay interest and return capital in the case of bonds, or share in the ownership of a company in the case of stock’. 

Article 2 of the CML’03 provides a list of what the term ‘security’ includes:

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229 An asset is any possession which carries value in an exchange. The term 'securities' means financial assets and financial instruments that are considered as tangible assets: see Frank J Fabozzi, Capital Markets: Institutions and Instruments (Prentice Hall, 3rd ed, 2003) 2.

230 George W Arnett, Global Securities Market: Navigating the World's Exchanges and OTC Markets (John Wiley & Sons, 2011) 2. A definition from a business and law dictionary: security is ‘a document issued by a government, semi-government body, statutory body, or public company in return for funds invested for a specific purpose by purchasers. Such securities are marketable’. They include bonds, debentures, shares, units, bills of exchange, and notes: see Nygh and Butt, above n 105, 431.
a. convertible and tradable shares of companies;

b. tradable 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 or the foregoing

Article 3 of the CML’03 excludes several types of financial products from being considered as securities. Commercial bills such as cheques, bills of exchange, order notes, documentary credits, money transfers, and instruments that are exclusively traded among banks, and insurance policies shall not be considered securities. The CMA has the power to exempt any specific instrument by regulation if it believes the safety of the market and the protection of investors do not require the instrument to be regulated as a security.231 However, judicial interpretation of the term ‘security’ is absent from the deliberations/findings of the courts in Saudi Arabia.

Securities are traditionally classified as equities, debts, hybrids and other instruments. Both corporations and governments may issue securities; corporations alone always issue equities. Equities are known as ‘ordinary shares’, and the most common form of equity is ‘common stock’.232 Common stock is mostly offered in the IPO by a company and then traded among investors on the secondary market. The buyers of common stock share the ownership of a company and are referred to as shareholders.233 Unlike in the case of equities, both corporations and government may issue debt securities. Bonds are debt instruments that have a fixed life.234

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231 See Capital Market Law 2003 (Saudi Arabia) art 2: The Capital Market Authority reserves certain powers only to the Board and does not allow them to be delegated to the Authority’s staff. A board meeting with a proper quorum can take a formal action exercise the reserved powers.

232 ‘Stock’ is a bundled set of shares: Nygh and Butt, above n 105, 451.

233 Foley, above n 91, 12.

234 Block, Hirt and Danielson, above n 87, 446–7.
A popular way for corporations to raise funds is a ‘hybrid security’, which involves issuing a form of hybrid debt that has characteristics of debt and equity.\textsuperscript{235} Hybrid securities are complex capital instruments issued by companies to expand their financial base and manage their cost of capital. Hybrid securities include: certain classes of preferred stock, trust preferred securities, convertible debt securities and mandatorily convertible instruments. The most common forms are convertible preference shares and convertible notes. Other instruments such as mutual funds and unit trusts can be used in investment in many kinds of securities.

In Saudi Arabia, companies can obtain the finance they need by offering securities in two main forms, namely, stocks and bonds. Firstly, stocks represent equity ownership in companies and such shares can be re-sold in the market either for cash or to modify investment portfolios. Stocks are divided into ordinary shares (common shares) and preferred stocks. Secondly, there are corporate bonds, which are debt instruments raised by companies in the securities market as a major source of long-term funding. Bonds differ among themselves in terms of the following properties: call ability, security offered, convertibility and risk.

### 2.7.2 Securities Regulation

Securities regulation is known as the laws that govern the securities industry. Securities regulation aims to ensure the smooth functioning of trading and clearing and settlement mechanisms that will prevent market disruption and foster investor confidence.\textsuperscript{236} Some scholars define the regulation of securities as the ongoing attempt to draw a balance between an efficient capital-raising process and the operation of an efficient securities

\textsuperscript{235} Pascal Quiry et al, Corporate Finance: Theory and Practice (John Wiley & Sons, 3\textsuperscript{rd} ed, 2011) 6.

However, securities regulation comprises the regulation of public issuers of securities, the secondary markets, and market intermediaries. Loss was the first scholar who called for securities regulation that would prevent the problems of fraud and market manipulation.238

Regulation of the market is mostly justified in terms of protecting the general investors from potential exploitation. Investor protection was a major concern for developing securities regulation in developed countries.239 In this regard, it has been submitted that the first objective of securities regulation is investor protection as stated by the International Organisation of Securities Commissions (IOSCO); the second objective is ensuring that markets are fair, efficient and transparent; and the third objective is the reduction of systemic risk.240

In Saudi Arabia, the practice of securities regulation is relatively new. The CML’03, which came into effect on 24 February 2004, establishes the basic framework for the regulation of securities activities in Saudi Arabia. It is considered to be the first national code to regulate both the primary and secondary securities markets in Saudi Arabia. The CML’03 also established the CMA, a government organisation with financial, legal and

239 Foley, above n 91, 196.
administrative independence.\textsuperscript{241} Chapter 3 of this thesis provides a thorough discussion of the legal and regulatory framework of the securities market in Saudi Arabia.

### 2.7.3 Investors

The term ‘investor’ is not a technical term with a precise legal meaning. The IOSCO has defined the term ‘investor’ in a general way by saying that the term ‘is intended to include customers or other consumers of financial services’.\textsuperscript{242} In terms of the course of action, one scholar defines the role of ‘investor’ as ‘to invest’ and the term to ‘invest’ as to spend money on something with an expectation of achieving financial returns.\textsuperscript{243} However, a specific and clear concept of the term ‘investor’ may be advisable in order to determine the actual scope of the application of securities regulation.

In this study, investors can be referred to, for example, as shareholders, stockholders, debenture holders, or bondholders. In addition, investors can be classified as ‘retail investors’ and ‘institutional investors’. The term ‘retail investor’ can be used simply as a way to differentiate individual investors from institutional investors. Thus, any individual who owns stock by any means, direct or indirect, could be defined as a retail investor. Investors have been classified as ‘sophisticated’ and ‘unsophisticated’ depending on their knowledge of investment. Institutional investors are generally ‘sophisticated’ and they invest considerable amount of money. On the other hand,

\textsuperscript{241} Chapter 3 provides a thorough discussion of the legal and regulatory framework of the securities market in Saudi Arabia; For more details regarding the market regulations, see Stephen P Matthews, Babul J Parikh and Aminta Paiva, ‘Financial Services Regulation in the Middle East’ in Timothy Ross (ed), (Oxford University Press, 2\textsuperscript{nd} ed, 2008) 149, 156.
\textsuperscript{242} IOSCO, ‘Objectives and Principles of Securities Regulation-2010’, above n 18.
\textsuperscript{243} Zufferey and Tschanz-Norton, above n 216, 59.
investors who are unable to make a knowledgeable investment decision are known as an ‘ordinary’, ‘general’, or ‘unsophisticated’ investor.\textsuperscript{244}

Furthermore, investors in the primary market can be classified according to their holdings of shares. Based on this, investors may be categorised as equity investors, debt investors, hybrids investors and other securities investors. Again, equity investors may be generally a separated into two segments, namely, primary shareholders and secondary shareholders. Investors in the secondary market can be classified into three types in Saudi Arabia. They are: investors who enter the market for long-term investment; traders for short-term investment; and speculators relying on quick profit-taking expectations.\textsuperscript{245}

The term ‘investors’ certainly includes those who invest in the IPOs. The subscription process is when the issuing company has its first offering of stocks for sale, which is known as the IPO. The IPO subscription is an offer from a buyer to purchase stocks which are soon to be issued. They are basically termed ‘subscribers’.

2.8 Investor Protection and the Development of the Securities Market

As was shown earlier, investor protection is the primary core objective of securities regulation set out by IOSCO.\textsuperscript{246} The aim of investor protection is to develop the market by facilitating fair transactions amongst market participants. The importance of investor protection is derived from the stock market collapses that have taken place in different

\textsuperscript{244} Ibid 74.
\textsuperscript{246} IOSCO, ‘Objectives and Principles of Securities Regulation-2010’, above n 18.
countries throughout history. These market crashes significantly contributed to the need for (and an increased awareness of the need for) stronger laws for investor protection.

In regard to the relationship between law and finance, La Porta et al demonstrate the link between investor protection and capital market activity. A recent study on the European markets shows that securities market with stronger regulation can produce significant financial returns.

In this study, the focus is the protection of investor rights in the securities market. This protection can be obtained through the laws that protect investors’ rights, and the effectiveness of the legal institutions that facilitate law enforcement. For this purpose, the preferred form of investor protection with which this thesis is concerned is the existence of a strong civil liability regime for breaches of the disclosure requirements. However, without effective enforcement machinery, liability laws will be inoperative.

2.8.1 The Importance of Disclosure in Relation to the Investor Protection

Disclosure is an effective tool to reduce informational asymmetry and facilitate informed decisions by investors. Mandatory disclosure of certain types of information is considered to be of assistance to investors and investment advisors in helping them to make an informed investment decision. According to a study carried out by Bushee and Leuz, information asymmetry is reduced by improved disclosure requirements. The

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247 Historical stock market crashes are, for example, in England in 1720, in the US in 1929 (and then worldwide), and in major world markets in 1987 and 2008, and in Saudi Arabia in 2006.

248 Rafael La Porta et al, 'Legal Determinants of External Finance', above n 19, 1131.


same study finds that newly compliant companies with the disclosure requirements show a significant increase in liquidity.\textsuperscript{251}

Accurate information is necessary to ensure that investors make optimal decisions. In this regard, the Technical Committee of IOSCO emphasises that:

Information should be disclosed on a timely basis, whether in connection with an initial public offering or listing, continuously, currently or periodically, and in a form or manner either prescribed by accounting standards, regulations, listing rules or law, together with the information that is provided by the management under the principles of fair presentation.\textsuperscript{252}

The regulation of information disclosure is a significant aspect in maintaining the integrity of the securities market. According to IOSCO, the fundamental purpose of disclosure is to provide investors with the information necessary to make informed investment decisions on an ongoing basis.\textsuperscript{253} Fox states that securities regulation should protect investors from making damaging securities choices as a result of being poorly informed.\textsuperscript{254} This shows the importance of mandating the disclosure of information.

Furthermore, a finding of the La Porta et al is that ‘both extensive disclosure requirements and standards of liability facilitating investor recovery of losses are associated with larger stock markets’.\textsuperscript{255} Their results suggest that ‘the development of stock markets is strongly associated with extensive disclosure requirements and a relatively low burden of proof on investors seeking to recover damages resulting from

\textsuperscript{251} Ibid 240.
\textsuperscript{255} La Porta, Lopez-De-Silanes and Shleifer, above n 4, 28.
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

omissions of material information from the prospectus'. In addition, securities regulators have found that the disclosure laws are a helpful means in their pursuit of making corporations tell the public about all their activities.

Easterbrook and Fischel assert that securities regulations have two components: a prohibition of fraud, and requirements for disclosure when securities are issued and periodically thereafter. DeFond and Hung found that countries with stronger investor protection rights show evidence of more informative annual earnings announcements.

Commentators state that the US securities laws are based on a philosophy of protecting investors through mandatory disclosure. These laws focus on two principal settings in which securities are bought and sold: issuer transactions (where securities are sold directly by an issuer, such as in a public offering or a private placement) and trading transactions (where securities are traded on secondary markets). The demand for information disclosure was not only for the regional market but also included the multinational corporations as ‘the development of information disclosure was taking place in the wide range of participants at national, regional and international level’.

In Saudi Arabia, flawed disclosure and the non-disclosure of material information is unlawful. The materiality of information is a concept in which encompasses that

256 Ibid 20.
258 Frank H Easterbrook and Daniel R Fischel, 'Mandatory Disclosure and the Protection of Investors' in Roberta Romano (ed), Foundations of Corporate Law (Oxford University Press, 1993) 303, 303
261 S J Gray, L B McSweeney and J C Shaw, Information Disclosure and the Multinational Corporation (Chichester West Sussex and New York, 1984) 47.
262 Details of disclosures requirements will be discussed in Chapters 4 & 5.
information which would have an impact on the security’s value or influence a reasonable investor in making an investment decision.\textsuperscript{263}

2.8.2 Disclosure Methods of Protecting Investors in the IPO Market

The major systems of IPO disclosure regulation depend on two philosophies, that of Merit-Based Regulation (MBR) and that of Disclosure-Based Regulation (DBR). MBR relies on the supposition that ordinary investors are not able to make prudent investment decisions even though companies disclose all material information. MDR requires securities regulators to assess the merit of proposed public offerings. This approach is generally associated with developing markets and may be of particular benefit where a market lacks a group of analysts and advisers who could analyse information if it were made publicly available. IOSCO considers MDR transitional and not necessary in a fully developed market.\textsuperscript{264}

On the other hand, DBR depends on ‘full, fair and true disclosure’ to the public. This philosophy relies on compliance with the disclosure requirement and the presumption that investors are able to assess the material information and make an informed investment decision. Hence, in DBR, the regulator has less responsibility for the merit of public offering. However, DBR is widely regarded as the optimal policy, especially in developed securities markets.\textsuperscript{265}

In Saudi Arabia, considering a hybrid approach combining MBR and DBR may be suitable for the development of the securities market, a hybrid system of regulation may be implemented by exempting some certain public offers from the regulatory merit

\textsuperscript{263} Discussion of the ‘concept of materiality’ will be provided in Chapters 4 & 5.


assessment. Moreover, this hybrid system may be more elastic regarding the disclosure requirement so investors will be responsible for making informed decisions.

2.8.3 The Meaning of the Disclosure Regime in this Study

A public company is required to make disclosure in three stages. The first is initial disclosures in a prospectus which is made at the time of a company’s initial public offering (IPO), that is, when a company first ‘goes public’. The second is continuous disclosures which are made at any time during the time that of the company is listed as required by events. The third is periodic disclosures which are made monthly, quarterly and yearly depending on the laws of a particular jurisdiction. The term ‘disclosure regime’ in this study will refer to the three types of disclosure mentioned above.

In regard to the content of the information disclosed by a public company, all material information has to be disclosed publicly so that investors are able to evaluate whether the information is important to his/her investment decision or not. Currently, disclosed material information includes financial affairs, pollution activities, securities ownership changes, payments to foreign governments, pending corporate takeovers, discoveries of oil or minerals, or any key factor one would need to know to make an informed decision.266 Because the disclosure arena is a contentious one, the law in this area is evolving; items disclosed today were often not required to be disclosed 30 years ago.267

2.8.4 The Concept of Civil Liability

The stated objectives of securities laws are to protect investors and to deter the misfeasance which is committed by individuals and institutions. In this sense, civil

266 Graham, above n 257.
267 Ibid.
liability can be a meaningful tool to provide protection for investors in the securities market. However, the concept of civil liability has been familiar to the major legal systems in the world: civil law, common law and Shari’ah.268 These three legal systems have recognised and defined the meaning of civil liability.

In civil law jurisdictions, civil liability arises from an historic statement of law found at art 1383 of the French Civil Code of 1804: ‘Everyone is liable for the damage he causes not only by his acts, but also by his negligence or imprudence.’269 Similarly, the German Civil Code of 1900 at § 823 described a person to be civilly liable as follows: ‘A person who, willfully or negligently, unlawfully injures the life, body, health, freedom, property or other right of another is bound to compensate him for any damage arising therefrom.’270

In common law jurisdictions, the law of civil liability for wrongs is called the law of torts. The law of torts defines the rights and obligations that arise when an individual commits a wrong against or injures another.271 Although the substantial part of tort law is based on common law, statutory liabilities are in place in the common law countries.

In Shari’ah, civil liability exists to compel the person responsible for an injury to compensate the injured party. It does not mean a form of deterrence as far as the

268 Civil law is a series of civil codes (the Civil Code of Napoleon, the German Civil Code and the Italian Civil Code) which an evolution of the Roman law. Common law was established by the Normans and developed in the territories of Great Britain. Common law is known as a jurisdiction where judges are bound primarily by precedents established by previous judgments. It is thus a ‘judge-made’ law. The Islamic legal system has been previously explained in the section discussing the legal system of Saudi Arabia which is based on Shari‘ah, and it became predominant in many North African, Middle Eastern and Central Asian states. For more details, see Emilia Justyna Powell and Sara McLaughlin Mitchell, ‘The International Court of Justice and the World’s Three Legal Systems’ (2007) 69 Journal of Politics 397, 398–9.
270 Ibid 557.
meaning of reparation of the losses caused by the wrongdoer. Hence, any unlawful act causing damage constitutes civil liability in Islamic law. Muslim jurists discuss civil liability under the title ‘dhaman’ which is Arabic word meaning commitment or responsibility to financial compensation for damages incurred by the injured party.\textsuperscript{272} In this respect, Sanhouri who is a well-known legal scholar refers the civil liability in Shari’ah to dhaman, which is a civil compensation.\textsuperscript{273}

2.8.4.1 The Meaning of Civil Liability in this Study

In this thesis, it can be generally said that the civil liability is the obligation for payment of damages that have resulted from flouting a law. Hence, the term ‘civil liability’ refers to compensation of investors or subscribers who may have sustained loss or damage resulting from a breach of the disclosure regime. In another word, civil liability is used here to describe the civil redress which is available to investors under the CML’03 and which may be exercised directly by them as well as through the CMA.

If liability is established, the liable party has to indemnify the victim for the damage. The meaning of indemnity is to make good the losses incurred by the victim. The compensation should be a payment for the entirety of the damage and not exceed the value of the damage done. It therefore does not entail any punitive damages.

In this thesis, the objectives of civil liability are to facilitate compensation for victims and thus to deter potential violators from breaching the disclosure requirements. This is


\textsuperscript{273} Abdul Razzak Al Sanhouri is a well-known legal scholar in the Arab world and often called the ‘father of the civil law and the son of Shari’ah’. See Hasan A Al-Thanon, \textit{Al Mabsoot in Civil Liability: The Damage} (Times Publications, 1991) [Arabic] 38.
in line with Shulman who affirms this when he wrote: ‘Civil liability is imposed partly
for the purpose of compensating investors, partly, and probably more, for the purpose of
compelling compliance with the Act so as to avoid certain types of losses and the need
of compensation.’\textsuperscript{274} In addition, Golding asserts that civil liability performs two
functions. First, it provides compensation for those who have suffered loss; and second,
it acts as a means of deterrence.\textsuperscript{275} The term ‘deterrence’ refers to encouraging the
avoidance of particular actions or omissions through fear of the perceived
consequences. Deterrence encourages persons to modify behaviour in order to comply
with the law.

Recently, Fox drew attention to the importance of initiating a civil liability system for
the violations of corporate disclosures.\textsuperscript{276} Hence it is important to answer a number of
questions: Who should be civilly liable for damages when a disclosure violation occurs?
According to what standard? For what amount? To whom? The CML’03 provisions
regarding civil liability for defective disclosures will be the focus of this thesis. In
addition, disclosure requirements and the enforcement machinery, especially the role
played by the securities regulator, will be under examination.

\textbf{2. 9 Summary and Conclusions}

The discussion shows that securities markets are a fundamental engine for corporate
funding by the public. In addition, the preceding covers the most used terms and
concepts in this thesis. In this chapter, the important role played by the securities market
in strengthening economic growth has been demonstrated. It can be clearly said that the

\textsuperscript{274} Harry Shulman, 'Civil Liability and the Securities Act' (1933) 43 \textit{Yale Law Journal} 227, 253.
\textsuperscript{275} Greg Golding, \textit{The Reform of Misstatement Liability in Australia’s Prospectus Laws} (PhD Thesis,
University of Sydney, 2001) 74.
\textsuperscript{276} Fox, ‘Civil Liability and Mandatory Disclosure’, above n 223.
Saudi securities market has gradually grown since the establishment of the first stock company in 1935. However, as with any emerging market, sustainable development is imperative in order to be in line with modern securities markets.²⁷⁷ It has been seen that despite the gradual development of the Saudi stock market since its inception, drawbacks persist and reforms need to be made.

It has been demonstrated that a number of drawbacks have slowed the development of the Saudi stock market. From an economic perspective, the Saudi stock market was recently classified as of low quality according to the FTSE criteria for emerging markets in the Middle East. In addition, as has been discussed, the market is mainly characterised by the following: a small number of listed companies, market volatility and the absence of foreign portfolio investment. Thus, potential investors prefer to deposit funds in bank accounts or invest in sectors other than the securities market.

Most importantly, it has been shown that market development is not satisfactory due to a lack of investor protection. The lack of transparency and disclosure coupled with an ineffective civil liability regime has significantly undermined the growth of the securities market in Saudi Arabia. It is submitted that adequate investor protection will strengthen transparency, restore investor confidence, reduce instability and attract local and foreign investment. Hence, the CMA is statutorily responsible for protecting investors from unlawful market practices, strengthening the disclosure regime and enforcing the securities laws.²⁷⁸

Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

Adequate disclosure practice and transparency is crucial for the development of the market and investor protection. A recent study on emerging markets has found that ‘[w]hen the informational efficiency in less developed markets is maximised, the market will be more efficient, which will eventually increase investor confidence and contribute to higher levels of economic activities’. 279

Securities regulation primarily aims to ensure fair trading, prevent market malfeasance, and foster investor confidence. All these ultimately relate to investor protection, which is the most crucial concern of securities regulation. Investor protection is initially provided by disclosure. The timeliness and accuracy of the disclosure of information is significant for investors in terms of their ability to make an informed decision. It has been shown that the disclosure regime in this study includes: prospectuses; and continuous disclosure and periodic disclosure. Civil liability for contravention of disclosure requirements is widely accepted to be an effective way of providing investor protection. La Porta et al find that ‘both extensive disclosure requirements and standards of liability facilitating investor recovery of losses are associated with larger stock markets’. 280

However, having a stock market is not enough. Developing such a market is important for the economy of any country. The development of the stock market has to reflect the wealth of the country. More importantly, effective regulations are required to be in place for the development of the market.

280 La Porta, Lopez-De-Silanes and Shleifer, above n 4, 28.
Chapter 2: Introduction to Saudi Arabia, Its Securities Market and Relevant Concepts

This study intends to strengthen the investor protection regime as the presence of adequate investor protection in the Saudi securities market has yet to be achieved. It appears that the current corporate regulations need to be more effective in order to maintain market growth and foster confidence amongst investors. As the present study is concerned with investor protection in regard to defective disclosures in the securities market, the next chapter will introduce the current legal and regulatory framework of the securities market in Saudi Arabia.
CHAPTER 3: LEGAL AND REGULATORY FRAMEWORKS OF THE SECURITIES MARKET IN SAUDI ARABIA

3.1 Introduction

This chapter aims to introduce the legal and regulatory frameworks of the securities market in Saudi Arabia. It provides a historical background, and discusses the present legal and regulatory framework. This chapter is divided into seven sections. Section 1 serves as an introduction. Section 2 describes the historical background of the legal and regulatory frameworks of the securities market in Saudi Arabia. Section 3 outlines the current legal framework of the market. In section 4, details of the present regulatory framework are provided. Section 5 shows the regulatory framework for disclosures. Finally, section 6 presents a summary and conclusions.

3.2 Historical Overview of the Legal and Regulatory Frameworks of the Securities Market in Saudi Arabia

3.2.1 The Former Legal Framework of the Securities Market

Despite the establishment of corporations between 1935 and 1965, there were no laws governing the securities market in Saudi Arabia. Company laws and regulations were completely absent. Islamic law (Shari’ah) was the main and only source governing civil and commercial transactions.\(^\text{281}\) Shari’ah did not differentiate between civil and commercial transactions. In Saudi Arabia, wali al-amr\(^\text{282}\) (the King) has the power to set rules and regulations to govern commercial activities as long as they do not breach Shari’ah, and this was done (see below) — but not specifically in relation to the securities market until much later, and as will be described further below, not to the extent desirable.

\(^{281}\) Hamdallah, above n 58; Alghamdi and Hussinie, above n 66.

\(^{282}\) Wali al-amr is an Arabic word. It means that the ruler, one in charge, legal guardian and/or governor of the state. See Al-Khudrawi, above n 272, 539. In Saudi Arabia, the King is the wali al-amr.
Chapter 3: Legal and Regulatory Framework

In 1927, the first regulation for commercial activities in Saudi Arabia was the *Nizam el majlis el tijari (Commercial Council Law 1927)*.\(^{283}\) This law was drafted by the Commercial Council in Jeddah and approved by the *Majlis Ash-Shura* (Consultative Council).\(^{284}\) Based on the *Commercial Council Law*, Rules for Companies Registration were issued and therefore a new branch of the Commercial Council was established, called the ‘Registrar of Commercial Companies’. Thus, all commercial companies and corporate bodies had to be registered with the Registrar of Commercial Companies.

In 1931, the *Nizam al mahkamah al tijaria (Commercial Court Law 1931)* was established and was considered to be the first comprehensive commercial law in Saudi Arabia.\(^{285}\) However, the *Commercial Court Law* did not survive because it was unable to cater for all commercial developments and changes. Therefore, it was cancelled in 1954. Thus, it can be said the Rules for Companies Registration was the foundation for the regulation of commercial issues in Saudi Arabia, including companies. Nevertheless, there were no laws to govern the securities market.

However, the issuance of the *Companies Law 1965 (CL’65)* served as the foundation for the development of the securities market; it was designed to establish clear and specific rules for corporations and to foster confidence amongst investors.\(^{286}\) This basic Saudi corporations law was put in place as the principal law regulating the primary

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283 It is considered the first attempt to draft regulations concerning the commercial activities and litigation in Saudi Arabia history.
284 *Majlis ash-shura* is a legislative body that advises the King on issues that are important to the State. Hamdallah, above n 58.
285 The *Commercial Court Law* contains 633 Articles divided into four sections. The sections are: Overland Trade; Maritime Trade; Procedural Commercial; and Output. The *Commercial Court Law* was cancelled in 1954.
286 The *Companies Law 1965* (Saudi Arabia) issued under Royal Decree No. M/6, dated 22/3/1385H and amended several times under Royal Decrees. Examples of these amendments:
  i. M/5 on 12/2/1378H
  ii. M/23 on 28/6/1402H
  iii. M/46 on 04/7/1405H
  iv. M/60 on 03/7/1428H
Seventeen corporations were in operation when this law came to existence, and the primary securities market was the only market formally operating. These companies were allowed to issue shares to the public. After the issuance of CL’65, more companies started issuing securities in the primary share market, but the secondary market activity was limited because of people’s lack of awareness about investment in company securities. Owning stocks tended, therefore, to be reserved for businesspeople. Apart from businesspeople, only those people who had had the opportunity to travel abroad were able to realise the benefits of investment; they too had therefore invested in securities. Nevertheless, the secondary market remained illiquid for a long time.

The CL’65 served as the only regulatory law of the Saudi stock market from its issue until 2003. Although CL’65 provided a foundation for the development of the Saudi share market until 2003, it was not adequate to the task of opening a formal stock exchange or, more broadly, a functioning capital market. Beach clearly observed that there were several drawbacks with CL’65, as it was the only source of regulation for the primary and secondary capital markets. These drawbacks were, namely, that the focus of the regulation was on the primary offering; a prospectus was not required to contain any useful information concerning the operation of the company; and issuer behaviour and advertising during the offering were not subject to regulation. It can be also

287 The ruler (wali al amr) issued a number of successive regulations in order to cover all commercial activities. Of these regulations, for example:
   i. Law of Commercial Papers 1964
   ii. Banking Control Law 1966
   iii. Commercial Books Law 1989
   iv. Commercial Agencies Law 1963
   v. Law of Trade Names 2000


289 Beach, above n 24, 317.

290 Ibid.
added that regulations within CL’65 regarding the secondary market were significantly incomplete.

Furthermore, the secondary market was mainly governed by the provisions of CL’65 as well as rules issued by the Ministerial Committee for the share market.291 In 1984, the Committee formulated executive rules292 to regulate trading in shares through local banks, which entitled only licensed Saudi banks to conduct services related to the purchase and sale of shares in Saudi listed companies.293

Al-Twaijry agreed that the entire focus of these regulations was on banks, to the exclusion of investors and other market participants.294 The provisions of CL’65 in covering the secondary market suffered from several obvious omissions. Firstly, there was no licensing or regulatory supervisory scheme for market intermediaries. Secondly, there was no regulatory supervision of significant continuous disclosure to investors. Thirdly, CL’65 did not address individual liability for wrongdoing and unlawful practices. Finally, there were no provisions concerning anti-competitive behaviour, such as market manipulation, insider trading, deceptive marketing, or most importantly, material information disclosure requirements. As Abdul-Hadi observed, by that time ‘although the government provided some regulations in the form of decrees, the Saudi

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291 In 1984, a Ministerial Committee composed of the Ministry of Finance and National Economy, Ministry of Commerce and Saudi Arabian Monetary Agency (SAMA) was formed to regulate and develop the market.
Chapter 3: Legal and Regulatory Framework

stock market lacked … uniform stock quotations, company news and reporting requirements'.

Consequently, it can be said that CL’65 failed to set adequate disclosure requirements for both the primary and secondary securities markets. Hence, a discussion of the CL’65 provisions for civil liability for defective disclosures will be largely unrelated to this thesis. This is because the Capital Market Law 2003 (CML’03) was subsequently implemented. This is supported by art 56 of the CML’03, which states: ‘This Law shall repeal all provisions that are contrary hereto.’

It is believed that ‘a weak legal system leads to significant market imperfections which affect the growth of the real economy.’ Until very recently, the securities market of Saudi Arabia may have been characterised by the lack of a formal regulatory agency or a specific legal structure to govern it. In 1984, Abdeen and Shook found that there was no organised legal framework for the stock market in Saudi Arabia. Nevertheless, it has always been known as a thriving market.

3.2.2 The Former Regulatory Framework of the Securities Market

Since the inception of the securities market of Saudi Arabia in 1935 and until 1948, there was no regulatory framework for the market. Instead, in 1986 the Ministry of Commerce (MoC) was empowered to administer companies. The MoC was entrusted with the organisation of domestic and foreign trade development. As mentioned in the

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295 Abdul-Hadi, above n 293, 49.
previous chapter, the stock market had been managed by unofficial brokerage firms who took advantage of the unregulated market. This situation led to share price volatility, loss of market credibility, and investor protection loss. Therefore, in 1984, a royal decree was issued by the King of Saudi Arabia to regulate the stock market. The decree stated that a ministerial committee would be formed, which would be in charge of overseeing all stock market activities. The committee consists of the representatives from the Ministry of Finance and National Economy (MoFNE), Ministry of Commerce (MoC), and Saudi Arabian Monetary Agency (SAMA)\(^{300}\). Consequently, the committee was given the power to issue rules and instructions for the stock market, but these rules and instructions were insufficient to govern all of the stock market activities.

3.2.2.1 The Role of the Ministry of Commerce (MoC)
The MoC is directly responsible for the formation of companies, conversion of firms to joint stock companies, and initial public offerings (IPOs). Thus, companies wishing to go public are required to fulfil five conditions and submit four documents. These conditions are that: net company assets are not less than SAR 50 million at the date of change; there is a return of not less than 7 per cent on shareholder’s equity in any one year of the three years preceding the change; the company should have been established for at least five years; it should place at least 40 per cent of the issued shares of the company; and it should have an able administrative system and shall have efficient internal controls to protect its net funds, and should have the ability to compete in the market.\(^{301}\)

\(^{300}\) SAMA is the central bank of Saudi Arabia.

\(^{301}\) Al-Dukheil, above n 156, 8.
Chapter 3: Legal and Regulatory Framework

Documents to be submitted are: articles of incorporation of the company; approval of company owners for the change of status; audited financial statements for the three years preceding the request for change; and a feasibility study for the company goals and future financial statements for the new company for the first three years, and a determination of the price of shares in the company.302

3.2.2.2 The Role of the Ministry of Finance and National Economy (MoFNE)

The function of the MoFNE is to manage all government finance, including the budgeting and expenditure of all ministries and government agencies, and to control national economic growth. The responsibilities of this ministry include the administration of zakat, income tax and customs duties.303 The MoFNE is a body that has a very strong influence on the financial system of the country through various policy directives and controls that it exercises from time to time. It controls the central bank of the country, the Saudi Arabian Monetary Agency (SAMA), which in turn controls the stock market from an operational and functional point of view.

3.2.2.3 The role of the Saudi Arabian Monetary Agency (SAMA)

SAMA, the central bank, governs the Saudi Stock Market regarding management and operations. Currently, only banking institutions that have been issued a licence under the Banking Control Law 1966 are authorised to be members of the Saudi Stock Market.304 These members use the Electronic Securities Information System (ESIS) to effect trades between clients/investors and traders.

302 Ibid.
303 ‘Zakat’ is an Arabic term, which means a fixed proportion of a person’s wealth that must be distributed on yearly basis for the benefit of the poor in the Muslim community: Al-Khudrawi, above n 272, 217.
304 Al-Dukheil, above n 156, 9.
In effect, the stock market structure was dominated by SAMA and the MoC. It was governed by rules and regulations issued and supervised by SAMA. However, demands grew for a restructure of the capital market and the establishment of a formal stock market with an independent regulator.  

Furthermore, Al-Dukheil made a call for a single regulator, pointing out that he felt that, ‘SAMA, as a central bank should not be directly involved in the day-to-day running of the stock market.’ He also states that ‘an independent regulatory authority comprising professionals from the public and private sector can set the policy directions and also establish a formal stock exchange on the lines of other developing and developed economies.’ Moreover, in terms of companies listed, the MoC can facilitate the conversion conditions that allow commercial companies to be listed on the stock market.

However, the stock market continued to be impeded due to the huge savings held by the public (and not invested) and a small number of listed companies in which it would be possible for them to invest if they so desired. In this regard, it is believed that a well-functioning stock market requires an adequate financial institution to hold public savings. A professional body to observe the securities market was absent until the establishment of the Capital Market Authority, as will be detailed in the following section.

305 Cordesman, above n 156, 443.
306 Al-Dukheil, above n 156, 41.
307 Ibid.
3.3 The Current Legal Framework of the Securities Market in Saudi Arabia

The current legal framework governing companies includes CL’65 and CML’03, the 
Listing Rules 3004 (LR’04) of the Capital Market Authority, and the Merger and 
Acquisition Regulations 2007 (MAR’07) Offers of Securities Regulations 2008 
(OSR’08). However, it should be noted that both LR’04 and MAR’07 apply to listed 
companies only. The OSR’08 regulates public and private securities placement.

The legal framework of the securities market currently consists of CML’03 as well as 
the rules and regulations issued by the Capital Market Authority (CMA). Generally,
companies listed in Saudi Arabia are governed by CL’65 and CML’03, and LR’04 and MAR’07 issued by the CMA. Although the formation and operation of all types of companies are governed by CL’65, it does not apply to stock exchange activities. The CML’03 is the sole statute that governs the work of the stock market.

3.3.1 The Major Saudi Securities Laws

In 1998, the legal department of SAMA commenced drafting the CML’03. Over the next four years, enormous assistance was provided by Professor James D Cox and Joseph W Beach to draft the rules necessary to implement this law and regulations to govern the activities of the Saudi securities market. The final draft was submitted to the Majlis Ash-Shura (Consultative Council) in December 2002. A Capital Market Law, comprised of 67 articles, was finally passed by the Council of Ministers in June 2003, with the law taking effect from November 2003 after publication in the Official Gazette. The law was not really implemented until July 2004, which added some ambiguity in the market. CML’03 has made a positive contribution to the development of the Saudi capital markets.

309 James D Cox is a professor of Duke University, School of Law. Professor Cox earned his BS from Arizona State University and law degrees at the University of California, Hastings College of the Law (JD), and Harvard Law School (LL.M). In 1998, Professor Cox was retained by SAMA to draft the Saudi Capital Market Law 2003 (Saudi Arabia).

310 Joseph W Beach is currently a Special Counsel in Cadwalader’s Charlotte office, USA. Beach received his BA from Davidson College, cum laude, and his MA in international relations from Duke University Graduate School. He received his JD, magna cum laude, and was a member of the Order of the Coif from Duke University School of Law. He was previously an associate at Dechert LLP. In 1998, Beach joined with Professor James D Cox to draft the Saudi Capital Market Law 2003.

311 Although many officials reviewed and commented on the draft law, the final version is remarkably unchanged in substance from our original draft: See Beach, above n 24, 308.

Many observers believe that ‘modernisation of the legal regime governing the Saudi capital market is a key to the economic future of Saudi Arabia.’\(^{313}\) Beach asserts:

> [T]he CML’03 will provide the legal underpinning necessary for growth and development of the Saudi domestic capital market. In the long run, such development should play a key role in advancing Saudi Arabia’s economic modernisation.\(^{314}\)

The majority of the articles of the new CML’03 have their basis in the securities statute from the US.\(^{315}\) The passing of the CML’03 was a major indication that policy makers in Saudi Arabia are serious about implementing reform strategies aimed at economic liberalisation, competition, and market efficiency.\(^{316}\)

The CML’03 consists of 10 chapters as listed below:

1) Definitions

2) The Capital Market Authority

3) The Stock Exchange

4) The Securities Deposit Centre

5) Brokers Regulations

6) Investment Funds and Collective Investment Schemes

7) Disclosure

8) Manipulation and Insider Trading

9) Regulation of Proxy Solicitations, Restricted Purchase and Restricted Offer for Shares

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\(^{314}\) Beach, above n 24, 320.

\(^{315}\) Beach also claims that: ‘Although many officials reviewed and commented on the draft law, the final version is remarkably unchanged in substance from our original draft.’ See Ibid 308.

\(^{316}\) Ramady, above n 104, 174.
10) Sanctions and Penalties for Violations

Furthermore, the government issued a number of regulations that could further underpin the purpose of investor protection in the securities market. These regulations are the *Foreign Capital Investment Law 2000*,\(^{317}\) the *Commercial Agencies Regulations 1962*,\(^{318}\) the *Government Bids and Procurement Law 2006*,\(^{319}\) the *Common Customs Law of the Gulf Cooperation Council States 2003*,\(^{320}\) the *Anti-Cover-Up Law 2004*,\(^{321}\) the *Competition Law 2004*,\(^{322}\) and the *Anti-Money Laundering Law 2003*.\(^{323}\) Processes of change and reform in Saudi Arabia are always needed, due to the growing economy and the need to attract foreign investment to the country, which require more effective laws and institutions.\(^{324}\)

### 3.3.2 Laws Governing Persons Involved in the Disclosure Regime

Companies in their initial procedures of going public — including company foundation, registration, and initial subscriptions — are regulated by the CL’65. In addition, CL’65 has provisions regulating the appointment and functions of directors and auditors and their liabilities to the company, shareholders and outsiders. Lawyers are governed by *The Code of Law Practice 2001*.

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However, the focus of this thesis is the civil liabilities for contraventions of the disclosures requirements set out in CML’03 and the CMA regulations. This is due to the fact that CML’03 and the CMA regulations have legal application over all practices and activities in the Saudi stock market. With the objective of improving the legal and regulatory framework of the securities market in Saudi Arabia, this thesis will demonstrate that the current regulatory regime has some shortcomings and that provisions for civil liabilities for defective disclosures are not sufficient. Moreover, defences and remedies for the civil liabilities for defective disclosures are inadequate. This will be seen through an examination of the three types of disclosures: prospectuses, periodical disclosures, and continuous disclosures. Discussion in the following chapters will demonstrate the inadequacy of the civil liability provisions in the CML’03.

3.4 The Existing Regulatory Framework

The issuance of the Capital Market Law 2003 (CML’03) was crucial in setting up an independent regulatory framework for the securities market in Saudi Arabia.325 A single Saudi Arabian securities regulator, the CMA, was established under CML’03.326 In addition, a remarkable feature of the CML’03 was the establishment of a Securities Exchange or bourse. The CML’03 also established the first national securities depository centre. Thus, it can be said that the trend of Self-Regulatory Organisation (SRO)327 has been adopted in Saudi Arabia when an authority is based on law or

325 Capital Market Law 2003 (Saudi Arabia) provides in art 4(a) that:
An 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.

326 Ramady, above n 104, 149.

327 The International Council of Securities Associations (ICSA) defines the Self-Regulatory Organisation (SRO) as ‘a private, nongovernmental organization that should be dedicated to the public interest objectives of enhancing market integrity, investor protection, and market efficiency’: see The
delegation of power by a statutory regulator. However, the SRO issue will be discussed further later in this chapter.\textsuperscript{328}

The CMA shall be vested with all authority as may be necessary to discharge its responsibilities and functions under the CML’03.\textsuperscript{329} According to art 4(b) of CML’03: ‘The CMA shall not have the right to engage in any commercial activities, to have special interest in any project intended for profit, to borrow or lend any funds, or to acquire, own or issue any securities.’

\subsection{3.4.1 Composition of the Capital Market Authority}

According to the CML’03, the CMA is to have a board named the Board of Capital Market Authority (BCMA). The BCMA is to be made up of five full-time members, including the chairman.\textsuperscript{330} The membership period is five years, which can be renewed only once. The CMA shall directly report to the President of the Council of Ministers.\textsuperscript{331} The CMA shall have a legal personality and financial and administrative autonomy.\textsuperscript{332}

\begin{flushright}
\textsuperscript{328} According to a recent working paper by John Carson, a full-fledged SRO performs three main regulatory functions: i. Rule making: Establishing rules and regulations governing the conduct of member firms and other regulated persons ii. Supervision: Supervising members and markets to monitor for compliance with the rules iii. Enforcement: Enforcing compliance with the rules by investigating potential violations and disciplining individuals and firms that violate them. For more details, see John Carson, 'Self-Regulation in Securities Markets' (Working Paper for World Bank Financial Sector Policy Group, 2010) 10.  \\
\textsuperscript{329} \textit{Capital Market Law 2003} (Saudi Arabia) art 4(a).  \\
\textsuperscript{330} The board members shall be appointed, and their salaries and financial benefits determined, by a Royal Order. The Royal Order shall specify from the board members the chairman and deputy chairman who will replace the chairman in his absence. \textit{Capital Market Law 2003} (Saudi Arabia) art 7(a).  \\
\textsuperscript{331} \textit{Capital Market Law 2003} (Saudi Arabia) art 4(a).  \\
\textsuperscript{332} Ibid.
\end{flushright}
3.4.2 Powers of the Board of the Capital Market Authority (BCMA)

According to the CML’03 (arts 7, 8, 9 and 10), the BCMA is assigned to perform the following powers:

i. The BCMA shall set forth the internal regulations of the CMA and the manner in which the personnel, advisors, auditors, and any other experts shall be appointed as may be necessary for carrying out the responsibilities and functions entrusted to the CMA.

ii. The BCMA shall exercise all authorities entrusted to the CMA in accordance with the provisions of this law.
iii. The BCMA will specify how the CMA functions, and responsibilities and operations will be organised among its divisions and departments. The Internal Regulations of the CMA will set forth the requirements for the operation of these departments and divisions.

iv. With the exception of the powers conferred by the CML’03 exclusively upon the BCMA, the Board may delegate any of its functions.

v. The Board shall, however, at its discretion, retain the power to review the actions and decisions made by those who had been delegated with such powers.334

According to art 11 of the CML’03, the chairman of the Board shall be the CMA’s chief executive officer, who shall implement the CMA’s policy and shall be responsible for the management of its affairs, including the following:

i. Implementing the decisions taken by the Board.

ii. Signing, alone or jointly with others, reports, accounting statements, financial statements, correspondence and the CMA’s documents.

iii. The CMA’s administrative and financial affairs.

3.4.3 Powers and Functions of the Capital Market Authority

Article 6 of CML’03 has given the CMA a wide range of powers to effectively supervise the market. These powers include the following:335

334 Such a review will be made at the CMA Board’s initiative, upon the request of one of its members or upon the request of a party to a lawsuit arising under the provisions of this law and in compliance with the rules issued by the CMA.

335 Capital Market Law 2003 (Saudi Arabia) art 6. These powers are the most relevant to the subject of this thesis. However, there are additional powers given to the CMA.
Chapter 3: Legal and Regulatory Framework

i. Set forth policies and plans, conduct studies, and issue necessary rules to achieve the CMA’s objectives.

ii. Issue and amend the implementing regulations as may be necessary to enforce the provisions of this Law.

iii. Approve the offering of securities.

iv. Suspend the Exchange’s activities for a period of not more than one day;

v. Approve, cancel, or suspend the listing of any Saudi Security traded on the Exchange of any Saudi issuer on any stock exchange outside the Kingdom.

vi. Prohibit any security or suspend the issuance or trading of any securities on the Exchange as the CMA may deem necessary.

vii. The CMA shall have the right to establish standards and conditions required for the auditors who audit the books and records of the Exchange, the Depositary Centre, brokerage companies, investment funds, and joint stock companies listed on the Exchange.

viii. Determine the contents of annual and periodical financial statements, reports, and documents that should be submitted by issuers offering securities for public subscription or the issuers whose securities are listed on the Exchange.

ix. Approve the regulations, rules, and policies of the Exchange and the Depositary Centre.

x. Prepare the regulations and rules for the surveillance and supervision of entities subject to the provisions of this Law.

xi. Appoint a licensed auditor to audit the CMA’s financial statements and final accounts.

xii. In accordance with the provisions of the CML’03, the CMA is empowered with the licensing of rating companies and agencies, and the conditions thereof.
Article 5 of CML’03 states that the CMA is to be the only regulator of securities markets in Saudi Arabia. Additionally, the law states that, ‘the CMA shall be the agency responsible for issuing regulations, rules and instructions, and for applying the provisions of this Law’.\textsuperscript{336} This function is combined with the objective of protecting investor interests, ensuring orderly and equitable dealing in securities, and promoting and developing the capital markets. In order to carry out the regulatory role, art 5 provides that the CMA shall be responsible for:\textsuperscript{337}

i. Regulating and developing the stock exchange.

ii. Regulating the issuance of securities, monitoring securities and dealing in securities.

iii. Regulating and monitoring the works and activities of parties subject to the control and supervision of the CMA.

iv. Protecting citizens and investors in securities from unfair and unsound practices or practices involving fraud, deceit, cheating, or manipulation.

v. Ensuring fairness and transparency in securities transactions.

vi. Regulating and monitoring the full disclosure of information regarding securities and their issuers.

vii. Regulating proxy and purchase requests and public offers of shares.

viii. The CMA may publish a draft of regulations and rules before issuing or amending them.

ix. For conducting all investigations, the CMA is empowered to subpoena witnesses, take evidence, and require the production of any books, papers, or other documents.

\textsuperscript{336} See \textit{Capital Market Law 2003} (Saudi Arabia) art 5(a).

\textsuperscript{337} Details of the CMA’s functions are stipulated in art 5: Ibid.
x. The CMA shall have the power to carry out inspections of the records or any other materials.

### 3.4.4 The Saudi Stock Exchange

Law makers soon realised the need to establish a formal stock exchange in Saudi Arabia. Article 20 of the CML’03 declares that a stock exchange with the legal status of a company be created that is called the ‘Saudi Stock Exchange’ (SSE). The SSE is to be the sole body with an authorisation to carry out trading in securities.

In accordance with the declaration given in the article above, the Saudi Stock Exchange (SSE) company was formed in 2007 as a joint stock company.\(^\text{338}\) A board of directors governs the SSE. The board is made up of nine members, three representing various government agencies, four representing the brokerages, and two representing the listed companies.\(^\text{339}\) Moreover, for the purpose of ensuring fairness and the protection of investors, the CML’03 allows the SSE to propose to the CMA the necessary regulations, rules, and instructions for its operation. This includes conditions for the listing and trading in securities and the minimum capital required for brokerage companies, as well as the financial assurances required from such companies or their employees. Moreover, the SSE is allowed by law to propose regulations and rules in relation to the immediate and timely publication of information regarding transactions executed in securities.

\(^\text{338}\) On 19 March 2007, the Saudi Council of Ministers approved the formation of the Saudi Capital Market Company with a capital of SR 1.2 billion [USD 331 million], converting TADAWUL from an automated trading system into a joint stock company fully owned by the public investment fund. For more details, see Saudi Stock Exchange (Tadawul), About Tadawul (2 October 2011) <http://goo.gl/xzsqq0>

\(^\text{339}\) According to the Capital Market Law of 2003 (Saudi Arabia) art 22(b): The membership will be as follows:

i. A representative of the Ministry of Finance.
ii. A representative of the Ministry of Commerce and Industry.
iii. A representative of the Saudi Arabian Monetary Agency.
iv. Four members representing licensed brokerage companies.
v. Two members representing the joint stock companies listed on the Exchange.
traded, and the obligations of issuers of securities, shareholders, and members to disclose such information to the SSE as the SSE deems necessary. The SSE has two main objectives: firstly, operating the market efficiently and delivering service excellence; secondly, developing a leading financial exchange by supporting competitive investment and financing channels. The objectives of the SSE are set out by the Board of the SSE. They are as follows: 340

i. Operate the market effectively and efficiently.

ii. Ensure market integrity, quality and fairness.

iii. Support investor education and awareness efforts.

iv. Develop service excellence for customers (brokers, issuers, investors, vendors, and so on).

v. Develop the SSE’s capabilities and competencies.

vi. Support efficient capital raising for companies.

vii. Provide innovative, diversified, and integrated financial markets, products, services, and instruments.

viii. Attract national and international market participants.

ix. Integrate and leverage offerings across our value chain.

x. Provide superior financial returns and shareholder value.

On the basis of the above description, it has been established that a having sole entity to exclusively carry out the function of securities trading will simplify the task of the regulatory oversight and concentrate them in one entity. Moreover, it can be said that the enabling nature of CML’03 has the flexibility to leave the SSE to develop itself. Finally, Table 3.7 below recognises the parties that are under the CMA supervision.

### Table 3.7: Parties Subject to CMA Supervision

<table>
<thead>
<tr>
<th>Party</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. TADAWUL</td>
<td>Tadawul is the sole entity authorised to carry out trading in Saudi Arabia in securities trading and is responsible for all operations of the SSE.</td>
</tr>
<tr>
<td>ii. Authorised persons</td>
<td>Legal entities authorised to carry on securities business and only persons holding a valid licence issued by CMA are allowed to perform this function.</td>
</tr>
<tr>
<td>iii. Listed companies</td>
<td>Companies whose securities are traded in the SSE.</td>
</tr>
<tr>
<td>iv. Traders</td>
<td>Entities representing the public who trade in securities in the SSE.</td>
</tr>
</tbody>
</table>

Source: The 2009 Annual Report of the CMA

Figure 3.7: Structure of the Present Regulatory Framework of the Securities Market in Saudi Arabia

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3. 5 The Regulatory Role of the CMA in Regard to Disclosures

Having effective disclosure regulations has become a fundamental element of regulatory improvement. By contrast, ineffective disclosure policy will lead to no advance in the regulatory objectives.342 This section describes the current regulatory framework of the disclosure regime in Saudi Arabia.

3.5.1 The Current Disclosure Regulatory Framework

Timely, accurate and adequate disclosures to investors are essential factors in ensuring the efficiency and integrity of any capital market. According to art 5 of the CML’03, the CMA regulates and monitors full disclosure of information associated with securities and their issuers and the dealings of informed persons (insiders), major shareholders, and investors.

Moreover, the CMA is empowered to define and make available the information that participants in the market should provide and disclose to shareholders and the public. Article 6 of the CML’03 grants the CMA the power to issue instructions and procedures necessary for regulating and monitoring the disclosure process. Currently, the CMA has regulatory powers to regulate and monitor two types of disclosure: IPOs and continuous disclosure which includes periodic disclosure.

3.5.1.1 Initial Disclosure

This refers to disclosing preliminary relevant information about any company whose shares are to be offered on the market for public subscription in accordance with the

Chapter 3: Legal and Regulatory Framework

OSR’08 and LR’04. Such information shall be disclosed through a prospectus, which must contain the following:

i. An adequate description of the issuer, its business, and the individuals in charge of its management, including members of the board of directors, executive officers and senior officials, and major shareholders.

ii. An adequate description of the securities to be issued or offered, in terms of their volume, price, relevant rights, privileges, and priorities of the issuer’s other securities, if any. The description must outline how the proceeds of the issue will be disbursed and the commissions levied by those concerned with the issue.

iii. A clear statement of the financial position of the issuer and any relevant financial date, including audited balance sheet, profit and loss account, and cash flow statement.

iv. Any other relevant information as may be required by the CMA. ³⁴³

3.5.1.2 Continuous Disclosures

The CMA treats any type of disclosure after the first sale of the security as a continuous disclosure. Therefore, ‘continuous disclosures’ covers all disclosures by a company subsequent to its IPO including periodic disclosures. The continuous disclosure refers to disclosure of the following information and data concerning participants in the secondary market:

i. Annual financial statements and reports;

ii. Quarterly interim financial statement;

iii. Significant developments and events (material information) about listed companies that can be of importance to investors and might affect the price of a company’s securities;

iv. Any developments or events related to capital increase or decrease;

v. Any change in the details of members of the board of directors, senior executives, and their relatives;

vi. Any changes in the company’s articles of association, headquarters or auditor.344

The CMA also:

i. Reviews the annual and quarterly financial statements of listed companies to ensure their compliance with the disclosure requirements stated in the CML’03 and the CMA regulations;

ii. Monitors corporate investments in the shares of listed companies;

iii. Reviews listed companies’ announcements of financial results, material developments, or events to ensure their compliance with the CML’03 and the CMA regulations, and all relevant instructions issued by the CMA;

iv. Monitors notifications related to the substantial ownership of shares by major shareholders, members of boards of directors and senior executives, to ensure their compliance with the CML’03 and the CMA regulations;

v. Monitors listed companies’ announcements of agreements and memoranda of understanding signed with unlisted company/companies concerning share acquisition or capital increase;

vi. Monitors the lifting of share lock-ups on founders in listed companies;

344 Ibid 69–70.
vii. Makes supervisory visits to listed companies to ensure their compliance with the CML’03 and the CML regulations.\textsuperscript{345}

In addition, the CMA is empowered to review annual and quarterly financial statements.\textsuperscript{346} The CMA reviews the detailed and condensed annual and quarterly financial statements of listed companies, which are posted on the website of the SSE to ensure that they meet all disclosure requirements according to the CML’03 and CML regulations.

3.6 Summary and Conclusions

Considering the short history of the CMA, it cannot be denied that there have been a number of improvements. The CMA has been enjoying its statutory powers to oversee the securities market in Saudi Arabia. As described earlier, since the inception of the CMA, there have been several rules and regulations issued by the CMA.

The foregoing discussion in this chapter has explained the legal and regulatory framework of the securities market in Saudi Arabia. It can be seen that CML’03 is primarily an enabling law, and nominates various entities to govern the day-to-day operations of the market. The CMA is created by the CML’03 to play the regulatory role in the securities market in Saudi Arabia.

Furthermore, it has been seen that the CML’03 gives the CMA the power to regulate and monitor disclosure (prospectus, periodic disclosures, and continuous disclosures) in the SSE. The aim of this power is to provide investors with full, fair, and timely disclosures, so that they can make informed investment decisions. In addition, one of

\textsuperscript{345} Ibid 70.
\textsuperscript{346} Capital Market Law 2003 (Saudi Arabia) art 6(a)(10).
the main purposes of the CMA is to maintain the integrity of the market and ensure the protection of investors. However, it has been found that the legal and regulatory frameworks of the securities market require considerable improvements in order to create and maintain effective protection of investors. There is a need for the issuing and updating of rules and regulations in order to strengthen the disclosure regime. Thus, the CMA is required to improve its function and make effective use of its statutory powers.

In brief, an adequate legal and regulatory framework of the stock market is essential for successful investments as well as a strong economy. A significant point is that investment always requires a healthy legal environment to sustain it. For that reason, it is often said that ‘strong capital markets, fostered by strong investor protections, ought to reduce a firm’s cost of capital and thereby encourage investment. Investment, in turn, ought to pay off in faster growth.’\textsuperscript{347} Moreover, a recent study asserts that ‘the results show that stronger securities regulation can have significant economic benefits.’\textsuperscript{348}

Generally, regulation aims to provide protection for investors. Effective laws and a proper regulatory framework can provide this protection. An empirical study of 49 countries across the world found that ‘countries with poorer investor protections, measured by both the character of legal rules and the quality of law enforcement, have smaller and narrower capital markets’.\textsuperscript{349} Thus, the legal and regulatory framework of the Saudi securities market needs to improve the protection of the investor which thus, in turn, will contribute to the further development of the market. A recent study asserts that ‘much of securities regulation is oriented toward investor protection, bringing with

\textsuperscript{348} Christensen, Hail and Leuz, above n 249.
\textsuperscript{349} Rafael La Porta et al, 'Legal Determinants of External Finance', above n 19, 1131.
Chapter 3: Legal and Regulatory Framework

it a set of investor rights, such as the right to certain disclosures.\textsuperscript{350} On the other hand, insufficient information about the market and its adherence to the international standards will lead to an undermining and isolation of the securities market. A recent report examining the compliance of Saudi Arabia with the Objectives and Principles of Securities Regulation set out by IOSCO reveals that there is not enough information publicly available to make an assessment of all relevant objectives and principles of the securities regulations.\textsuperscript{351} Therefore, the following chapters will examine the effectiveness of the present legal and regulatory framework in relation to civil liability for defective prospectuses. It is believed that a legal framework that is based on deterrence effectively protects investors in the securities market.\textsuperscript{352} Hence, the provisions for civil liability for defective disclosures will be also examined in the following chapters.

CHAPTER 4: CIVIL LIABILITY FOR DEFECTIVE DISCLOSURES IN A PROSPECTUS UNDER SAUDI SECURITIES LAWS

4.1 Introduction

Investor protection requires a combination of both rights written into laws and regulations, and effectiveness in their enforcement. Shleifer and Wolfenzon found that poor investor protection laws led to a decrease in public confidence in the securities market, as well as having a significant effect on firms’ capital inflows from the public. Having a strong civil liability regime can strengthen investor protection. Civil liability for defective prospectuses provides incentives to comply with the requirements and thereby foster investor confidence.

A securities market with a strong disclosure regime can evidently bring growth, efficiency and integrity to the financial market. Disclosure of all material information is essential for the protection of investors against deception, and for the efficient functioning of financial markets. It is of the utmost importance for a successful primary market. In efficient securities markets, information about a firm or company is incorporated quickly and accurately into stock prices.

Companies that are willing to go public and are looking to raise funds are required to inform the public about the actual state of the company and the nature of future activities. A prospectus must have the information legally required in order to allow the

353 Rafael La Porta et al, 'Investor Protection and Corporate Governance', above n 19, 15; La Porta, Lopez-De-Silanes and Shleifer, above n 4, 3.
354 Shleifer and Wolfenzon, above n 19, 19.
356 The terms ‘firm’, ‘company’ and ‘corporation’ will be used interchangeably in this thesis.
potential participants to make an informed investment decision. The prospectus is regarded as the most important document containing information about the Initial Public Offering (IPO). It is asserted that ‘sufficient investment information is significant for the prevention of “bad” IPOs in a disclosure regime’.\footnote{S M Solaiman, ‘Investor Protection by Securities Regulators in the Primary Share Markets in Australia and Bangladesh: A Comparison and Contrast’ (2009) 16(4) Journal of Financial Crime 305, 322.} Therefore, ‘full, fair and true prospectuses’\footnote{The term ‘full’ means ‘complete’. ‘Fair’ means just; equitable; equal; proper’. The term ‘plain’ is that which is ‘clearly understandable’. See Md. Anowar Zahid and Andrew McGee, ‘Prospectus Disclosure and the Role of the Securities Commissions in Ontario and Bangladesh: A comparative Study’ (2002) 4(2) International and Comparative Corporate Law Journal 163, 180.} are essential to the integrity of the primary share market.\footnote{In addition, the set of the adjectives ‘full, true and plain’ and ‘full, fair and timely’ are also used in describing the type of disclosure contained in the prospectus. For details, see Condon, Anand and Sarra, above n 237, 597.}

Having effective disclosure regulation is widely regarded as an appropriate strategy for adoption in developed securities markets.\footnote{Solaiman, ‘Disclosure Philosophy for Investor Protection in Securities Market’, above n 265.} Thus, the imposition of civil liability for non-compliance with the disclosure requirements for a prospectus is essential for the protection of investors. In order to do this, the compensation of investors who suffer loss or damage from defective disclosures is the core purpose of civil liability. The preparation of the prospectus involves input from a number of sources, such as the issuing company, its directors including the managing directors, the company secretary, auditors, lawyers, issue managers and underwriters.

However, it is important to stress that an important aspect of regulation here is to make certain that there is accuracy and adequacy of the ‘material information’ disclosed both in relation to the issue and the issuer. Information is considered as material if it could be expected to have an effect on the share value if it were publicly known or could be expected to have influenced an investment decision by a reasonable investor had they...
been aware of that information. The function of such information is to help the investors assess the issuer’s business, assets and liabilities, financial positions and so on.\textsuperscript{362}

The civil liability regime for defective prospectuses in Saudi Arabia is still unclear or not broad enough as compared to that of developed countries. The lack of investor confidence in the securities market is the result of numerous incidents of malpractice by corporations and their professionals and intermediaries.

This chapter aims to examine the current civil liability provisions for a prospectus in Saudi Arabia. In particular, the extent and the scope of these provisions will be measured in terms of whether they provide satisfactory protection for investors in the securities market. For this purpose, the chapter will be divided into nine sections: Section 1 provides an introduction, and Section 2 identifies and evaluates the disclosure requirements in a prospectus in Saudi Arabia. Section 3 focuses on the objectives of civil liabilities for the prospectus. Section 4 identifies the scope of the defective prospectus under the Saudi securities law. Section 5 explores the provisions of civil liability for a prospectus in Saudi Arabia and outlines civil liability provisions for the prospectus in selected developed countries. Section 6 gives an evaluation of the civil liability provisions for disclosure in prospectuses in Saudi Arabia. Section 7 deals with the arguments against the expansion of the civil liability to every person who participated in preparation of the prospectus. Finally, Section 8 provides a summary and conclusions. The concluding comments will demonstrate that the civil liability provisions for prospectuses do not completely favour investor protection in the IPO or primary market in Saudi Arabia.

\textsuperscript{362} Zahid and McGee, above n 359, 181.
4.2 Disclosure Requirements for a Prospectus

The obligation to entirely disclose information when advertising securities to the public was developed in the late 19th century, when rapidly increasing commercial and speculative activities permitted promoters to sell securities on an inadequate basis of information and facts. As a result, the courts established precedents via rulings in common law jurisdictions to ensure that persons who invite the public to buy securities comply with strict rules that aim for accuracy. Specifically targeted legislation, legislative amendments, and the creation of regulations and their further amendment, have progressively tightened disclosure requirements.

An issuer, who is going to offer securities for sale, is required to prepare a prospectus that contains information about the company. The role of the law is to impose requirements on the offeror to provide an accurate prospectus. The content of the prospectus is important in relation to the market’s determination of the correct price of the security. It has been pointed out that ‘the greater the informative content in the prospectus, the better the pricing accuracy’. In the IPO market, it has been submitted that ‘[e]very new issue had to be accompanied by a prospectus signed by the directors and containing the information specified by schedules provided for in the Acts’.

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364 For example, in response to such activities, the UK courts developed rules to ensure full and fair disclosure by securities promoters. Securities promoters are ‘bound to state everything with strict and scrupulous accuracy’ and with ‘the utmost candour and honesty’. See New Brunswick & Canada Ry Co v Muggeridge (1860) 1 Dr & Sm 363, 381; Central Ry Co of Venezuela v Kisch (1867) LR 2 HL 99, 113.
Chapter 4: Civil Liability for Defective Prospectuses

Hence, it can be agreed that a prospectus is the document that business institutions produce to describe the securities being offered to potential capital market participants and subscribers. It serves as the investors’ source of material information about the issuers and underlying securities in which they would like to invest.

With accurate information, investors can make responsible and informed investment decisions. In this respect, finding laws that in Saudi Arabia and elsewhere govern the prospectus and the requirements established by regulators can greatly assist an examination of the adequacy of the prospectus liability regime in Saudi Arabia. Prospectus laws and requirements will be investigated in the light of the jurisdictions of the United States (US), the United Kingdom (UK), Australia and Canada. These countries have more developed and better regulated securities markets. As the obligation to disclose is essentially connected with liability for misstatements made in the course of disclosure, this section will discuss the general requirements of prospectus of the four selected jurisdictions, as well as of Saudi Arabia. A comparison is then made in respect of the sufficiency of the prospectus requirements in Saudi Arabia.

4.2.1 Prospectus Requirements under Saudi Laws

In Saudi Arabia, a prospectus is governed by the Capital Market Law 2003 (CML’03) and the Listing Rules 2004 (LR’04), which govern every aspect of the requirements for prospectus documents. The issuer, or affiliates of an issuer or an underwriter, is required to provide a prospectus to the Capital Market Authority (CMA). They are not allowed to sell securities before a prospectus has been submitted and approved by the CMA.

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367 Justifications for the selections of these developed countries were stated in the methodology section of this thesis. See Section 1.7.
368 See Capital Market Law 2003 (Saudi Arabia) art 40(b); Listing Rules 2004 (Saudi Arabia) art 11(b)(4).
369 See Capital Market Law 2003 (Saudi Arabia) art 40(c); Listing Rules 2004 (Saudi Arabia) art 13(a).
Chapter 4: Civil Liability for Defective Prospectuses

The CML’03 prescribes the content of a prospectus, which must contain all information required by the CMA.370 Article 12 of the LR’04 stipulates that:

The prospectus must contain all information which is necessary to enable an investor to make an assessment of the activities, assets and liabilities, financial position, management and prospects of the issuer and of its profits and losses and must include information in relation to the obligations, rights, powers and privileges attaching to the relevant securities.

The content of a prospectus must be compliant with listing rules issued by the CMA. In addition to the general requirements of information content to be disclosed, LR’04 provides the minimum information that the issuer is required to provide. These specific and minimum requirements are detailed in Annex 4 and 5 in the LR’04.371 Requirements for disclosure in a prospectus must contain both financial information and non-financial information. Financial matters are those such as the breakdown of net turnover of the issuer for the three financial years immediately preceding the date of publication of the prospectus, the financial statement of issuer on a consolidated basis, and a report by certified accountants that has been prepared in accordance with the requirements.372 The non-financial information includes material such as details of the

370 This information is stated in Article 42 of the CML’03 as follows:

The prospectus must contain the following information and statements:

a. Information required by the Authority’s rules which give an adequate description of the issuer, the nature of its business, the individuals in charge of its management such as members of the board of directors, executive officers, senior staff and its major shareholders.
b. Information required by the Authority’s rules which give an adequate description of the Securities to be issued, their number, price, and related rights, preferences or privileges of the issuer’s other Securities, if any. The description will set forth how the issue proceeds will be disbursed, and the commissions levied by persons connected with the issue.
c. A clear statement of the financial position of the issuer and any significant financial data including the audited financial balance sheet, profit and loss account and cash flow statement as the rules of the Authority may require.
d. Any other information required or authorized by the Authority in accordance with rules issued by the Authority which it deems necessary to assist investors and their advisers in making decisions about investing in the Securities to be issued.

371 Listing Rules 2004 (Saudi Arabia) art 12; Annex 4 sets the minimum information that must be included in a prospectus for shares or debt instruments convertible into shares. Annex 5 sets the minimum information that must be included in a prospectus for debt instruments.

persons involved in the companies offer and preparation, an adequate description of the issuer; the nature of its business; the individuals in charge. Materials required include details of the securities to be issued; and a clear statement of the financial position of the issuer and the audited financial balance sheet, profit and loss account and cash flow statement as the rules of the Authority may require.376

The CML’03 grants the CMA the power to review the prospectus and make a decision whether to approve or reject the prospectus. The CMA regulations and rules shall set forth the information to be disclosed.377

4.2.2 Prospectus Requirements under Developed Countries’ Laws

The Australian Corporations Act 2001 (Cth) (CA’01) regulates the three types of disclosure documents here relevant:378 the prospectus, profile statement, and offer information statement. The CA’01 imposes the highest level of information disclosure burden on offerers of securities that require a prospectus.379 Therefore, information required under s 710 of the CA’01 needs to be generated and made public. The section contains requirements for a prospectus, including the general disclosure test requiring

373 ‘Balance sheet’ is a statement of an accounting entity’s financial position, providing a summary of the assets, liabilities and owner’s equity of the entity at a given date. Nygh and Butt, above n 105, 56.
374 ‘The profit and loss account’ is a financial statement providing a summary of an accounting entity’s revenues, expenses, gains, losses and resulting net profit or loss, for a given period of time. Ibid, 389.
375 ‘Cash flow’ is the earnings remaining after paying all expenses including wages, interest payments, taxes and dividends. Ibid, 83.
376 Capital Market Law 2003 (Saudi Arabia) art 42.
377 According to the art 45 of the Capital Market Law 2003, the Board of the Authority may reject a prospectus in any of the following cases:
   a. If the prospectus does not contain the information required by Article 42 of this Law.
   b. If the prospectus contains incorrect information pertaining to material matters, false or misleading statements or omits to state material information or statements that would, under the circumstances, render the prospectus misleading or incorrect.
   c. The prospectus issuance fees have not been paid in full to the Authority.
   d. The issuer has failed to provide any of the reports stipulated in Article 45 of this Law.
378 For more details, see the definition of ‘disclosure document’ in the Corporations Act 2001 (Cth) s 9.
Chapter 4: Civil Liability for Defective Prospectuses

the disclosure of ‘all the information that investors and their professional advisers would reasonably require to make an informed assessment’ of the securities.\footnote{Corporations Act 2001 (Cth) s 710(1).} The specific information that must be included in the prospectus is prescribed in s 711. In addition, the rules governing ‘disclosure operation of offers involving continuously quoted securities’ are detailed in s 713. The procedure for offering securities is detailed under s 717, which requires compliance by the person who intends to offer securities to the public.

In accordance with s 718 of the CA’01, a prospectus must be lodged with the Australian Securities and Investments Commission (ASIC). Section 739 of the Act gives ASIC the power to suspend a securities offer before it is issued or transferred on the basis of contraventions of prospectus requirements. ASIC has recently issued a ‘Regulatory Guide 228: Prospectuses: Effective Disclosure for Retail Investors’ which offers guidance to issuers and advisers on how to word and present prospectuses and other documents in a ‘clear, concise and effective’ manner.\footnote{ASIC, Regulatory Guide 228 Prospectuses: Effective Disclosure for Retail Investors (November, 2011) \url{<http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg228-published-10-November-2011-1.pdf>$file/rg228-published-10-November-2011-1.pdf>}.}

In the UK, s 80 of the \textit{Financial Services and Markets Act 2000} (FSMA’00) establishes the general duty of disclosure in listing particulars.\footnote{‘Listing particulars’ means a document in such form and containing such information as may be specified in listing rules: \textit{Financial Services and Markets Act 2000} (UK) c 8 s 79(2).} Sections 84–87 of the FSMA’00 provide general guidelines on prospectus requirements. Most importantly, s 85 makes it illegal to offer shares without an approved prospectus. Section 85(1) provides that:

Chapter 4: Civil Liability for Defective Prospectuses

It is unlawful for transferable securities to which this subsection applies to be offered to the public in the United Kingdom unless an approved prospectus has been made available to the public before the offer is made.383

The prospectus is governed by the FSMA 2000, which delegates to the Financial Service Authority (FSA) the power to make rules for a prospectus. The FSA has implemented Prospectus Regulations 2005,384 which implemented the European Union’s Prospectus Directive385 that came into force on 1 July 2005.

At present, the FSA implements three sourcebooks, which form a block known as the ‘Listing, Prospectus, and Disclosure and Transparency Rules’ (‘UK Prospectus Rules’).386 These rules regulate the publication of information in relation to the issue of securities. They provide details on the requirements relating to the content of the prospectus. The UK Prospectus Rules incorporate detailed information requirements including, for example: information about the issuer; financial information; information regarding the investment objective, policy and restrictions; information regarding managers, advisers, and other service providers; organisational structure/administration and management details; and risk factors.387

In Canada, a company must prepare a prospectus when it offers securities to the public.388 The Ontario Securities Act 1990 (OSA’90)389 and the National Instrument

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383 Ibid c 8, s 85(1).
386 See Lorenzo Sasso, 'Listing and Disclosure Rules in UK: Some Recent Changes' (2008) 2 Contratto e impresa Europe 1, 1. The rules referred to are Listing Rules (LR), Prospectus Rules (PR) and Disclosure and Transparency Rules (DTR).
388 In Canada, securities issuers subject to a prospectus requirement have four options: they can use a long-form prospectus, a short-form prospectus, a base-shelf prospectus followed by a prospectus supplement, or they can issue under an exemption. This chapter concerns the long-form prospectus, which
Chapter 4: Civil Liability for Defective Prospectuses

41:101 General Prospectus Requirements 2006 set out the requirements of a prospectus. Section 53(1) of the OSA’90 requires a prospectus by saying that:

No person or company shall trade in a security on his, her or its own account or on behalf of any other person or company if the trade would be a distribution of the security, unless a preliminary prospectus and a final prospectus have been filed and receipts have been issued for them by the Director.390

Also, s 56(1) of the OSA’90 prescribes that the prospectus must provide, ‘full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed and shall comply with the requirements of Ontario securities law’. The Ontario Securities Commission (OSC) is the regulatory body responsible for overseeing Ontario’s capital markets, which include the equity securities. It has the sole power to approve prospectuses.

In the United States, the Securities Act 1933 (SA’33) is the principal statute that governs the offer and sale of securities in the public market. In addition, the offer and sale of securities in the United States is prohibited unless they are registered with the Securities and Exchange Commission (SEC).391 As a part of the registration statements, a prospectus is required to be filed with the SEC. Section 7 (15 USC § 77g) of the SA’33 and Schedule A392 describe the information required in the registration statement and statutory prospectus. Section 10 (15 USC § 77j) deals with the required information by

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390 Securities Act 1990 (Ontario) c S.5, s 53(1).

391 Securities Act 1933 (US) § 6. Note: Also codified at 15 USC § 77f (1933) [Registration of Securities and Signing of Registration Statement].

392 The law sets forth 32 detailed items to be included in the registration statement. See Schedule A to the Securities Act 1933 (US).
Chapter 4: Civil Liability for Defective Prospectuses

the SA’33 to be contained in a prospectus. The SA’33 grants the SEC the power to
review, approve and adopt rules that are able to amend required information from a
prospectus. Moreover, under the legislation, the SEC promulgated Regulation S-K\textsuperscript{393} and Regulation S-X,\textsuperscript{394} requiring the issuer to disclose additional information when
offering securities to the public.

In brief, it can be said that there are twofold information disclosure requirements for the
prospectus: general disclosure and specific disclosure. General disclosure is to contain
all information legally required to enable the investors to make an investment decision.
The general disclosure is to include sufficient description of the nature of the securities
in question and the issuer. Usually the general disclosure requirements in a prospectus
are statutory requirements, with the specific requirements set out by the securities
regulatory body on the basis of a statutory power.

It has been seen in the earlier description, in Saudi Arabia, prospectus requirements can
be generally found in the CML’03 and with greater detail in the LR’04.\textsuperscript{395} In relation to
the content of a prospectus, the issuer will be required to satisfy the minimum
information requirements — as set out in LR’04 — for the issue of the prospectus.\textsuperscript{396}
However, the CMA can impose additional requirements on the issuer in regard to
information provided to ensure adequate disclosures in a prospectus.\textsuperscript{397}

\textsuperscript{393} Regulation S-K [17 CFR Part 229] Standard Instructions for Filing Forms under the \textit{Securities Act
\textsuperscript{394} Regulation S-X [17 CFR Part 210] Form and Content of and Requirements for Financial Statements,
\textsuperscript{395} Capital Market Law 2003 (Saudi Arabia) art 42; \textit{Listing Rules 2004} (Saudi Arabia) art 12 and Annex 5
\textsuperscript{396} \textit{Listing Rules 2004} (Saudi Arabia) art 12.
\textsuperscript{397} Ibid.
Although there are both general and specific prospectus requirements in Saudi Arabia as there are in those of developed countries, disclosures in prospectuses continue to be inadequate under the current regime. The following evaluation of the prospectus requirements under the current Saudi securities laws will demonstrate that the current disclosure regime is unable to provide sufficient protection for the investors in the IPO market.

4.2.3 Evaluation of the Prospectus Requirements under Saudi Laws

The preceding description of the prospectus requirements of selected developed countries can be used to measure the adequacy of such requirements in Saudi Arabia. Laws governing disclosures in prospectuses, competent authorities for issuing prospectus requirements and information required to be disclosed will be examined. In Saudi Arabia, as in the selected developed securities markets, there is similarly a principal statute governing the prospectus. In addition, there are regulations that come under the main statute in order to ensure the full and fair disclosure in prospectuses. All jurisdictions require the company to publicise the prospectus when issuing new shares. Thus, companies going public must meet the prospectus requirements of the CML’03 as the principal statute in Saudi Arabia and the LR’04. However, since the issuance of the CML’03, there have been no amendments regarding prospectus requirements provisions. This may be due to the securities law in place in the country being so comparatively recently enacted and therefore there being a lack of cases for interpretation by courts, which could otherwise assist in the discernment of weaknesses in the law.

All jurisdictions have a single body which is empowered by the statute to regulate IPOs and issue rules regarding the prospectus. In Saudi Arabia, the CMA (as the competent
authority) issues rules, instructions and procedures for the implementation of the provisions of a prospectus. Similar to the equivalent bodies in the US, the UK and Canada, the CMA has the power to review, approve and reject the prospectus. In Australia, ASIC can also suspend a prospectus by issuing a stop order. However, the CMA remains weak in exercising its regulatory and enforcement powers concerning disclosures in a prospectus.398

It is worth mentioning that the above art 12 of the LR’04, which provides further requirements for the prospectus, is copied verbatim from the European Union Prospectus Directive 2003/71/EC (Article 5(1)). The requirement of ‘all’ information implies ‘true’ information. It can be noted that information must be comprehensible to ordinary investors as the purpose of disclosure is to inform the investors of the issuer’s financial and relevant non-financial matters (that is, all matters required by the legislation, all material matters). In other words, the disclosure must be in a plain language. Thus, the Saudi requirement may be interpreted as calling for ‘full, true and plain’ information — a ‘catch-all’ requirement. In this way, the Saudi requirement is similar to the Canadian (Ontario) requirement. The Canadian (Ontario) requirement is ‘full, true and plain’ information’.399 ‘Material information’ is information that the non-disclosure of which will impact on the market price of securities as it influences investor decision making. Put simply, Canadian law, in effect, calls for all information to be disclosed that would help investors make a sober investment decision. In the same manner, the US, the UK and Australia call for ‘all’ information for informed assessment of securities by reasonable investors and intermediaries. In the same way, Saudi law

398 See Chapter 9 which examines the CMA’s role in regard to a disclosure regime.
399 For more discussion in regard to the meaning of full, true and plain disclosure, see Zahid and McGee, above n 359, 180.
requires the disclosure of financial and non-financial disclosure in prospectuses. For example, the basic requirements of financial disclosure in a prospectus include the disclosure of the audited annual report and accounts of the issuer for each of the three financial years immediately preceding the application for the public offer. In addition, the company is required to provide the interim financial statements issued since the date of the last audited report and accounts. The published audited accounts covering at least the last three financial years, must be prepared in accordance with the accounting standards issued by the Saudi Organisation for Certified Public Accountants (SOCPA).

Indeed, having the basic requirements for financial and non-financial disclosures in a prospectus are essential to ensure that disclosure is full. However, it can be suggested that due to the complexity of the financial information to the ordinary investors, prospectus has to be prepared in plain and easy language and to avoid technical and complex terms from the prospectus. Hence, investors can be able to have a readable understanding of the company and thus make an informed investment decision.

In Australia, ASIC has proposed more specific requirements to avoid too general financial information provided in prospectus. The proposition is to require information relating to key financial information and key financial ratios.

It is submitted that adequate and improved prospectus requirements lead to better protection of investors in the primary market. For that reason, developed countries have
an effective mechanism to ensure adequate disclosure in the prospectus. They have ongoing development to enhance further these requirements. Hence, it is believed that these countries have sufficient legal requirements governing disclosures in a prospectus. However, for the sake of market integrity, the following discussion will show that prospectuses require additional rules and regulation in Saudi Arabia.

In the UK, prospectus regulations have significantly improved in the past decade. There have been additional rules and directives on the disclosures to be implemented in a prospectus. In Australia, ASIC has a policy of continually improving the regulations regarding disclosures in prospectuses. In addition to the prospectus requirements stipulated in the CA’01, ASIC has implemented the *Regulatory Guide 56 1996* which provides additional instruments for the prospectus requirements. In addition, ASIC has recently published draft guidelines on prospectus disclosure in order to assist the preparation and presentation of prospectuses in a clear, concise and effective manner as required by s 715 (a) of the CA’01. In Canada, there has been considerable focus on improving and updating the prospectus requirements by the Canadian Securities Administrators (CSA). For example, in order to strengthen the disclosure regime in the IPO market, the OSC has adopted several rules and instruments proposed by the CSA, such as the *National Instrument 41-101 General Prospectus Requirements and Related Amendments 2006* and *National Instrument 45-106 Prospectus and Registration*

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405 The Canadian Securities Administrators (CSA) is a voluntary umbrella organisation of Canada’s provincial and territorial securities regulators whose objective is to improve, coordinate and harmonise regulation of the Canadian capital markets. Canadian Securities Administrators, 'Introduction to Canadian Securities Administrators' (2012) <http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSAPresentation20120116VF.pdf> 5.
Chapter 4: Civil Liability for Defective Prospectuses

**Exemptions 2005.** In the United States, the SEC has, as a part of its regulatory role, also undertaken reforms and amendments regarding the prospectus requirements to advance significantly the registration, communications, and offering processes under the SA’33. For example, the SEC invited interested persons to suggest ‘reasonable measures which might be taken to improve the readability and informativeness of prospectuses’.  

Unlike in developed countries, the matters of issuing new rules for, or improving or amending, prospectus requirements have not been prioritised in the Saudi Arabia. Indeed, no new rule, or improvement to or amendment of requirements in respect of prospectuses have been made since the CML’03 and LR’04 came into existence, despite the CML’03 giving the CMA the power to amend, update and issue rules and regulations in order to administer the stock market. However, it can be clearly seen that the CMA has not been acting in a manner favourable to investors in terms of ensuring proper disclosures in the IPO market. The CMA is required to utilise its powers more effectively and in conformity with Principle 7 of the IOSCO Objectives and Principles which states that the ‘regulator should have or contribute to a process to review the perimeter of regulation regularly’.

Given that the CMA is the sole regulator of securities market in Saudi Arabia, calls for development of the prospectus regulatory framework continue to have a place amongst the market investors and professionals. Companies that decide to go public are required

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406 For more details, see Ontario Securities Commission, ‘Prospectus Offerings’, above n 388.
to provide all required information and make full disclosures in their prospectuses. Equally important, the CMA is required to adopt effective measures to check the accuracy of the information provided in the prospectuses. For instance, incorrect information provided in the prospectus of the Integrated Telecom Company (ITC) misled investors and also resulted in subsequent defects in the financial reports, consequently, trading in the ITC’s shares has been suspended.411 Investors in ITC blame the CMA for not adopting effective verification of the content in the prospectus.412

Thus, a general test of disclosures in prospectuses is preferable to monitoring the accuracy of information disclosed in the prospectus. The test of the information in the prospectus is adopted by most developed countries. The test is known, for example, in Australia as the ‘reasonable investor’ test. The test targets a requirement of disclosure of information that investors and their professional advisers would ‘reasonably require’ in a prospectus and it is the responsibility of the issuer to determine what information may be required beyond the specific information.413 In the UK, the general test is aided by the prescriptive requirements of Schedule 1 to the Public Offer of Securities Regulations 1995 (comprising 51 disclosure items to be addressed).414 In addition, in the United States, there is a general test of disclosure of additional material information that underpins the prospectus laws.415

411 The ITC prospectus was approved by the CMA on 11 April 2011, and trading in the company suspended on 1 April 2012: Capital Market Authority, An Announcement in Regard to Suspending the Trading of the Saudi Integrated Telecom Company’s Shares, 1 April 2012 <http://www.cma.org.sa/En/News/Pages/CMA_N_1132.aspx>.
412 Bajubayr, above n 34.
413 Corporations Act 2001 (Cth) s 710(1). See also Golding, above n 275, 223.
414 See Public Offer of Securities Regulations 1995 (UK) Schedule 1. See also Chapter 6 of the Listing Rules of the UK Listing Authority.
415 See Rule 408 was promulgated under the Securities Act 1933 (US).
Chapter 4: Civil Liability for Defective Prospectuses

Unlike the selected countries above, in Saudi Arabia, there is no effective mechanism to ensure that a prospectus has no misstatements or omissions. Adoption of such a mechanism would assist investors to make an informed decision based on accurate disclosure. Additionally, it would reduce the number of poor companies that enter the securities market without strong economic fundamentals. It is recommended that, as in developed countries, issuers be responsible for the determination of what information may be required beyond the specific information.

Under the CML’03 and CMA rules, issuing companies are not required to undertake a due diligence process during the preparation of a prospectus. Lawyers, auditors and underwriters have a responsibility to ensure the accuracy of a prospectus during the company’s process of going public. The emphasis on their role in regard to the prospectus requirement is absent in the CML’03 and ignored by the CMA.

Indeed, in order to improve the accuracy and transparency of the information in prospectuses, companies should undertake a process of verification prior to the finalisation of any prospectus. Verification of a prospectus involves checking each material statement of fact or opinion to ensure that it is accurate and complete. The due diligence process is undertaken for reasons such as the following: to make reasonable inquiries to ensure the prospectus is complete and accurate; and to enable the

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417 For example, the Australian Corporation Act 2001 requires companies to make all reasonable enquiries in relation to the offer. The process of due diligence is undertaken by the key participants in the IPO process, including: directors, the underwriter, lawyers and accountants. The duty of the key participants is to verify the information in the prospectus and issue the final approval of the prospectus to be publicly released. See Australian Securities Exchange, IPO: The Road to Growth and Opportunity (10 April 2012) <http://www.asxgroup.com.au/media/PDFs/asx_ipo_brochure.pdf> 17.
corporation’s directors and advisers to be able to avail themselves of the appropriate defences allowed by law.\textsuperscript{418}

It is believed that having a requirement that imposes upon companies an obligation to undertake a due diligence process will not only benefit the accuracy of the prospectus, but will afford the persons involved in the prospectus preparation with a defence in relation to their potential liability for a defective prospectus. Moreover, effective verification of all material information included in the prospectus will reduce the likelihood of misleading statements and assist investors to make an informed investment decision. A recent study of 16 new listed companies on the SSE found that the financial performance of these companies declined after going public.\textsuperscript{419} Hence, the market administrator needs to investigate the decline in financial performance of newly listed companies in order to put in place appropriate measures and rules for new listings.

Furthermore, it has been submitted that disclosure requirements for prospectuses should be presented in a clear, concise and effective manner.\textsuperscript{420} However, a survey conducted of the 500 largest private firms in Saudi Arabia revealed that ambiguity in regulations that cover fundamental IPO issues is a major barrier to private firms contemplating going public.\textsuperscript{421} This shows that the CMA has a key role in regulating and facilitating the IPO market by improving the disclosure requirements for a prospectus.

Based on the above, it can be clearly concluded that the current disclosure regime regarding the prospectus requirements is weak and, therefore, investors are lacking

\textsuperscript{418} The due diligence defence will be discussed in details in section 7.4 of this thesis.
\textsuperscript{420} Corporations Act 2001 (Cth) s 715(a).
protection in the IPO market. Hence, proper protection of investors in the IPO market requires a more effective regulator, improved rules, and an effective process of verification prior the finalisation of any prospectus, and should also require that a prospectus be presented in a clear, concise and effective manner.

4.3 Objectives of Prospectus Civil Liability

The main object of imposing liability for a defective disclosure is to provide protection for investors or speculators, whether they are investors in an IPO where a company is going public (the primary market) or involved in later transactions, often between investors (the secondary market).\(^{422}\) Deterrence is generally created by liabilities for misconduct in every respect for the wrongdoers.\(^{423}\) In addition, a legal framework based on deterrence effectively protects investors in the securities market.\(^{424}\)

With respect to increasing the liquidity of shares of a company in the market, the civil liabilities regime has twin objectives: firstly, to ease compensation for the victims of defective continuous disclosure; and secondly, to deter persons who may potentially otherwise become involved in breaching disclosure provisions and requirements.\(^{425}\) It is thought that social utility is mostly gained by deterring corporate misconduct and, therefore, imposing a strong civil liability regime can be the most efficient means of

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\(^{422}\) The terms ‘investors’ and ‘speculators’ are used interchangeably in this thesis. The secondary market will be covered in Chapter 6: ‘Civil Liability for the Secondary Market Disclosures in Saudi Arabia: Periodic Disclosure and Continuous Disclosure’

\(^{423}\) Fox, ‘Civil Liability and Mandatory Disclosure’ above n 223, 281.

\(^{424}\) Golding, above n 275, 329; see also Solaiman, ‘Investor Protection in a Disclosure Regime’, above n 352, 193.

Chapter 4: Civil Liability for Defective Prospectuses

deterring corporate misconduct.426 A comprehensive civil liability regime for defective
disclosures in prospectuses is of vital importance in order to fully ensure a high level of
investor protection, which is the main objective of the disclosure philosophy.427

In Ford’s Principles of Corporations Law, it has been clarified that, ‘civil wrongs
comprise a person’s acts or omissions which bring liability to pay compensation to
someone who suffers loss caused by an act or omission’. It is also there stated that, ‘the
primary function of liability for civil wrong is provision of compensation commensurate
with the harm suffered’.428 Thus, it can be clearly asserted that civil liability for
defective disclosure in a prospectus works in favour of investor protection.

4. 4 Defectiveness of Prospectuses in Saudi Securities Law

4.4.1 Meaning and Scope of Term ‘Defective Prospectus’ in Relation to Saudi
Securities Law

The phrase ‘defective prospectus’ is broad and general. Hence, the defective prospectus
includes the ‘misstatement in prospectuses’, ‘misrepresentation in prospectuses’ and
‘untrue statement in prospectuses’, which phrases are commonly used to signify a
defective prospectus.429 Initially, the meaning of the term ‘defective’ is that, ‘if
something is defective, there is something is wrong with it and it does not work
properly’.430 Hence, a prospectus identified as being defective is a document
accompanying an offer of securities, which does not comply with the requirements

& Public Policy 833, 857.
427 Solaiman, 'Investor Protection by Securities Regulators in the Primary Share Markets', above n 358, 312.
428 R P Austin and Ian M Ramsay, Ford's Principles of Corporations Law (LexisNexis Butterworths, 14th
429 The phrase ‘false or misleading’ is also used to signify the defective prospectus.
430 The term ‘defective’ means having a fault or faults; not perfect or complete. Another meaning is
‘faulty’, for example, defective goods. See A S Hornby, Oxford Advanced Learner's Dictionary (Oxford
Chapter 4: Civil Liability for Defective Prospectuses

either because it does not contain all the material required or because it contains a misleading or deceptive statement.\(^{431}\)

Secondly, the meaning of the term ‘misstatement’ refers to stating wrongly or incorrectly or to the giving of false information. The term ‘untrue statement’ or ‘misstatement’ is used in the broader sense. As a result, an ‘untrue statement’ means a statement which is in fact untrue, not a statement that, in the belief of the directors, is untrue.\(^{432}\) It includes not only false statements but also statements that produce a wrong impression of actual facts.\(^{433}\) The term ‘misrepresentation’ is also used to signify a defective prospectus. Misrepresentation associated with contractual commitments means ‘a false material statement of fact intended to induce another person to enter a contract, and relied on by that person to their detriment’.\(^{434}\) The US Court of Appeal that in SEC v Manor Nursing Centers Inc,\(^{435}\) held that a defective prospectus is materially false and misleading, even when a prospectus in the correct form is duly delivered, if that prospectus contains material inaccuracies in the information included.

Furthermore, disclosure of the information required to be stated in the prospectus is essential to investors who intend to participate in the IPOs. Therefore, omissions from a prospectus can mislead investors’, affecting their decisions (and even be to their disadvantage). It is said that a successful plaintiff must demonstrate that, among other

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\(^{431}\) This trend of defining the defective prospectus is adopted by the *Corporations Act 2001* (Cth): see ss 710–15.

\(^{432}\) Not only the directors but also include promoters, or even the company.

\(^{433}\) This result is found by Komal Dave, who also defines the ‘misstatement’ as ‘a falsehood or concealment or an ambiguity or an exaggeration – all of these have the potential to mislead a prospective investor in the company’. For more details, see Komal Dave, *Company Law - Liability for a Misstatement in a Prospectus* (18 December 2012) <http://jurisonline.in/?p=172>.

\(^{434}\) Nygh and Butt, above n 105, 323.

\(^{435}\) 458 F 2d 1082 (2nd Cir, 1972).
things, an omission is misleading.\textsuperscript{436} Hence, an omission in a prospectus is omitting to state a material fact that is required to be stated in the prospectus.\textsuperscript{437}

Arguably, it is stated that the prospectus must be taken as a whole.\textsuperscript{438} It may be misleading in that prospectus statements are correct but incomplete. This can create a false impression. English law states that the omission must be of a fact, and is of importance only when that omission renders other facts to be false.\textsuperscript{439} In addition, under US securities law, there is a duty to disclose special information not known to the purchaser.\textsuperscript{440}

It can be found under art 55(a) of the CML’03 in Saudi Arabia that a defective prospectus refers to, ‘a prospectus [that] contained incorrect statements of material matters or omitted material facts required to be stated in a prospectus’. Despite the possibility that this definition might be satisfactory, it does not encompass that omission of any necessary detail where such an omission would give a misleading impression of other material in the prospectus. Similar to the English law’s definition of omission, the Saudi definition of a defective prospectus finds that an incomplete prospectus could be acceptable. Moreover, art 55(a) of the CML’03 does not stipulate that an incomplete prospectus is misleading as suppression of material fact, but imposes civil liability for defective prospectus if any damage occurs because of such an omission.

\textsuperscript{436} Arnold S Jacobs, 'What Is a Misleading Statement or Omission under Rule 10b-5?' (1973) 42 Fordham Law Review 243, 244.
\textsuperscript{437} Ibid. It was decided that ‘the misstatement contained in the prospectus must be material’. See Greenwood v Leather Shod Wheel Co. (1900) 81 LT Rep 1 Ch 421.
\textsuperscript{438} The basis of this statement is: ‘Lord McNaughton has precisely stated that the prospectus must be taken as a whole for “everybody knows that half a truth is no better than a downright falsehood”’. See Dave, above n 433.
\textsuperscript{439} Ibid.
\textsuperscript{440} The Securities Act 1933 (US) § 11(a); 15 USC § 77(k)(a) (1933) imposes liability for the omission of any material fact that should be have been included in the prospectus; or any necessary detail where such omission would give a misleading impression of other material in the prospectus.
4.4.2 The Materiality Requirement

With respect to investment in securities, the concept of material information can be referred to information that would have affected a reasonable investor in making an investment decision. The current preferred judicial standard\(^{441}\) for determining materiality in securities litigation holds that an omitted fact is material where there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote or to purchase or sell stock.\(^{442}\)

The UK Court of Appeal in *Cackett v Keswick*,\(^ {443}\) the judge states that information is considered material if it induces or deters a reasonable investor in regard to an investment decision. Moreover, omission from information that which would have an impact on the investment decision is considered misleading.

The concept of materiality is important within the context of securities in the United States because under s 15 of the *Securities Exchange Act 1934* (US) (SEA’34), a company can be held civilly or criminally liable for false, misleading, or omitted statements of fact in documents, if the fact in question is found by the court to have been material. In the US, information should be disclosed if there is a substantial likelihood that a ‘reasonable investor would consider it important to an investment decision.\(^ {444}\)

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\(^{443}\) (1902) 2 CH 456 [2].

Chapter 4: Civil Liability for Defective Prospectuses

The present and most common statutory standard in Canada is called a ‘market impact’ test, that is, it involves information that should be disclosed is information that would affect the price or value of the issuer’s securities. In Australia, a corporation must disclose information to the Australian Securities Exchange (ASX) in accordance with the Listing Rules, where the information involved is that which a reasonable person would expect to have a material effect on price or value. According to ASX Listing Rule 3.1, materiality must be assessed having regard to all the relevant background information, including past announcements that have been made by the Company, and other generally available information. In the UK, the court in Rex v Kylsant held that the prospectus was misleading not because of what is stated but because of what it concealed or omitted which was considered material information.

The materiality of statements or omissions in a prospectus is required by art 55(a) of the CML’03. Thus, a defectiveness of a prospectus must be associated with materiality. Article 55(a) states that statements or omissions are to be considered material if it is proven that the statement or the omission contained in the prospectus has affected the investor’s purchase price. It can be seen that despite materiality being required with respect to omissions and inclusions, a clear standard to determine what should be considered material under the Saudi prospectus provisions is absent. This means that

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447 ASX Listing Rule 3.1 lists the following examples of information which, if material, must be disclosed to the ASX: forecasts; insolvency; transactions; dividends declared; dividend not declared; issue of securities; and tracing beneficial ownership of shares.
448 (1932) 1 KB 442.
449 Article 55(a) of the Capital Market Law 2003 (Saudi Arabia) defines the material fact in a prospectus: ‘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’.
450 Ibid.
Chapter 4: Civil Liability for Defective Prospectuses

there is an imperative need for effective mechanism on the ground to determine what information may be considered material. A recent comparative study confirmed that, ‘the materiality test can be an important element in examining misstatements even though it is not generally required by the statute’. As per art 55(a), the court is entitled to decide whether the inclusions or the omissions in the prospectus are material or not. In Coleman v Myers, it was suggested that omissions or misstatement of material facts must be information that investors would take into account in making their decision. This contradicts the articulation of the materiality under Saudi law. Article 55(a) of the CML’03 stipulates that misstatements or omissions of material facts must be information that, to investors, would affect the price of the purchase. In other words, materiality is associated with the true value of a security that has been affected by the inclusions or omissions of information. However, it may be better to state that material information would have an impact when making investment decisions.

To sum up, the preceding discussion of what can be considered a defective prospectus shows that art 55 of the CML’03 may not be adequate to successfully identify a defective prospectus. Furthermore, the above discussion shows that despite there being a requirement for materiality under the CML’03, this requirement remains insufficient and requires further explanations. Therefore, persons that might otherwise be held liable can escape liability because of the inadequacy of the Saudi prospectus law in respect of materiality. In order to have a strong civil liability regime for defective prospectuses, it is imperative to identify what constitutes a defective prospectus, including a proper definition of the materiality. Consequently, protection of investors requires an adequate prospectus requirement coupled with strong articulation by the regulator to create an

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451 Khoo, above n 363, 60.
452 (1977) 2 NZLR 255.
effective deterrent to potential wrongdoers. In this respect, it can be clearly said that art 55 of the CML’03 requires further improvements in order to achieve better protection for investors. In addition, the responsibility of the CMA is to establish effective methods to determine what information may be treated as material information.

4.5 Civil Liability for a Defective Disclosure in a Prospectus

Persons involved in the preparation of a prospectus must comply with certain statutory requirements and rules imposed by the securities regulatory body. Civil liabilities will be imposed on those who are involved in the contraventions of prescribed prospectus requirements under the CML’03 and the LR’04.

To this end, this section will describe the prospectus civil liability provisions in Saudi Arabia and selected developed jurisdictions. Saudi securities law contains a number of provisions stating the requirements for a prospectus. These can be found in the CML’03 and LR’04. These provisions require the issuer to produce a prospectus that contains all information for prospective subscribers prior to the selling of the issuer’s securities. Information is specified in the LR’04, and is divided into six categories: general information; information about the conditions of issue of the shares for which application is sought; information about the issuer and its group; financial information about the issuer and its group; information about management; and information about the documents available for inspection.

4.5.1 Civil Liability Provisions Dealing with Prospectus Liability in Saudi Arabia

Civil liability for defective disclosures in prospectuses is found in art 55 of the CML’03. Investors who suffer damages resulting from a material misrepresentation in a prospectus can sue to recover damages. Article 55(a) of the CML’03 states that:
Chapter 4: Civil Liability for Defective Prospectuses

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.

Liability is imposed on certain persons for any untrue statement included in the prospectus. Article 55(b) of the CML’03 identifies a number of persons who may be subject to civil liability for a defective prospectus. The following persons will become liable for compensation of the subscribers to the prospectus:

i. The issuer

ii. The senior officers of the issuer

iii. The directors of the issuer

iv. The underwriters who have undertaken to offer, on behalf of the issuer, the security for sale to the public

v. The accountant, engineer or appraiser and others identified in the prospectus, who have consented in writing to be so identified, as having certified the accuracy and truthfulness of the information stated in the prospectus

Civil liability is clearly imposed on the issuer, senior officer, director, underwriter, accountant, engineer and appraiser. In addition, liability is imposed on any other person

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454 There is no definition for ‘senior officer’ under the CML’03 and CMA rules and regulations. However, senior officers can be those who hold positions in the management of a company, and it may include senior executive officers.

455 Underwriter: a person who buys securities from the issuer or an affiliate of the issuer for the purpose of offering, placing and marketing such securities to the public, or a person who sells securities on behalf of the issuer or an affiliate of the issuer for the purpose of making a public offering and placement of such securities. Capital Market Authority, ‘*Chapter One Definition*’, above n 453.
who accepts responsibility for any part of the prospectus in order to certify that all information contained in a prospectus is accurate and true. However, it is unclear whether or not the other persons involved in the preparation of the prospectus (such as issue managers, promoters and lawyers) fall within the ambit of this liability.

The above provisions of the CML’03 have not been interpreted by the courts in Saudi Arabia because of the serious dearth of cases involving allegations of the contravention of these provisions. Thus, the liability of participants other than persons categorically mentioned in the above law is yet to be determined under these provisions.

Civil liability, in this discussion, refers to the compensation of investors or subscribers who may have sustained loss or damage by subscribing to an IPO. Civil liability for defective prospectuses is found in the art 55(a) of the CML’03, which states that in the case of a defective prospectus, investors are entitled to seek compensation. The prospectus subject to civil liability, when approved by the authority, contains incorrect statements of material or omitted material facts required to be stated in the prospectus.

For claims based on art 55(a), compensation for aggrieved investors comes as damages that represent the difference between the purchase price of the security (not to exceed the price at which it was offered to the public) and the price of the security when bringing the legal action to the court.\footnote{Capital Market Law 2003 (Saudi Arabia) art 55(e).}

On the other hand, if the defendant proves that the investor’s loss was not due to the defective prospectus in question, such loss shall be excluded from the damages for which the defendant is responsible.\footnote{Ibid.} The defendants are jointly liable for
Chapter 4: Civil Liability for Defective Prospectuses

compensation. Thus, the amount of indemnification is to be subject to: the provisions of the contract or agreement entered between the liable persons and the investor; or what the court believes is equitable and does not harm the interest of investors or otherwise contravene the spirit of the CML’03.\footnote{458}{Ibid.}

Another issue is that of art 56 of the CML’03, which is described as the ‘anti fraud provision’.\footnote{459}{Beach, above n 24, 348.} It is unclear whether this provision may apply to disclosure violations in the primary market. Article 56(a) states that:

Any person who makes, or is responsible for another making, orally or in writing an untrue statement of material fact or omits to state that material fact, if it causes another person to be misled in relation to the sale or the purchase of a Security, shall be liable for compensation of the damages.

The articulation of art 56(a) is similar to that of § 18(a) of the SEA’34. Section 18(a) provides civil liability for any false or misleading statement made in any document filed with the SEC. Similarly, art 56 may be applied to both primary and secondary markets.\footnote{460}{Article 56 of the CML’03 and its applicability to the defective disclosures in the secondary market will be thoroughly discussed in the Chapter 6: ‘Civil Liability for the Secondary Market Disclosures in Saudi Arabia: Periodic Disclosure and Continuous Disclosure’.} As mentioned above, art 56(a) is the anti-fraud provision against any defective statement filed with the CMA. Keller and Gehlmann declared that ‘although section 18(a) of the Securities Exchange Act 1934 (US) parallels section 11 of the Securities Act, it is less effective because, unlike sections 11 and 12, section 18(a) requires the buyer to prove that he/she read the statement, and actually relied on the material misrepresentation’.\footnote{461}{Keller and Gehlmann, above n 366, 350. See also art 56 of the Capital Market Law 2003 (Saudi Arabia).}
However, the discussion of prospectus civil liability will strictly focus on art 55 of the CML’03. This is because that art 55 provides an express and clear civil liability for defective disclosures made in prospectuses. Beach states that art 55 of the CML’03 closely mirrors the US provision on liability for misrepresentations in a prospectus.462

The following will outline the civil liability provisions dealing with prospectus in the selected developed jurisdictions.

4.5.2 Civil Liability for Defective Disclosures in a Prospectus under the Laws of Selected Developed Countries

The scope of civil liability and persons liable will be investigated in the light of the statutes and judicial precedents of the US, the UK, Australia and Canada. Each of these countries has developed a better regulated securities market.

In the US, §§ 11 and 12 of the SA’33 deal with the liability for disclosure in a prospectus. Section 11 imposes civil liability for untrue disclosure or nondisclosure of material facts on every person who signs the registration statement.463 Additionally, this section clearly states the liability of directors, experts,464 underwriters,465 and ‘any person whose profession gives authority to a statement made by him [or her], who has with his [or her] consent been named as having prepared or certified any part of the registration statement…’.466 Section 12 of the SA’33 imposes civil liability on any

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463 15 USC § 77a (1933) (US). A prospectus is a part of the registration statement required for an IPO to be filed with the US Securities and Exchange Commission. In the US, the ‘registration Statement’ is a prepared set of documents, including a prospectus, which is filed with the Securities Exchange Commission prior to an Initial Public Offering.
464 ‘Experts’ include accountants, engineers, or appraisers, or any person whose profession gives authority to a statement made by him or her, who has with his or her consent been named as having prepared or certified any part of the registration statement: Securities Act 1933 (US) § 11(a)(4); 15 USC § 77k(a)(4) (1933).
465 ‘Underwriters’ includes managing underwriters.
466 Securities Act 1933 (US) § 11(a)(4); 15 USC § 77k(a)(4) (1933).
person who is involved in the preparation of a prospectus that contains untrue
statements or omits to state a material fact.

In Canada, s 130 of the OSA’90 imposes liability on the issuers, underwriters, directors
and every person who has signed the prospectus. The term ‘every person’ refers to
persons other than those who are already mentioned in the section by title. As a
result, the OSA’90 exposes every person who has signed a prospectus to civil liability
for that prospectus.

In Australia, s 728 of the CA’01 states the liability for misleading or deceptive
statements or material omission in a prospectus. Section 729 imposes civil liability on
persons who are accountable to compensate investors who sustained consequential loss
or damage from their subscription to an IPO caused by the defective prospectus. The
persons liable under s 729 of the Act are: the person making the offer, directors,
underwriters, persons named in the ‘disclosure document’ with their consent as
having made a statement, and a person who contravenes or is involved in the
contravention of the prohibitions against the inclusion of misleading or deceptive
statement or omission of material information from the disclosure document.

In the UK, s 90 of the FSMA’00 specifies those persons who can be held liable for a
defective prospectus. Persons will include the issuer and anyone who accepts
responsibility for or has authorised the prospectus. Thus, those persons are responsible

\[\text{Chapter 4: Civil Liability for Defective Prospectuses}\]

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467 The Danier case was the first prospectus liability action under s 130 of the Securities Act 1990 (Ontario). See Kerr v Danier Leather Inc (2007) 3 SCR 331.
468 Securities Act 1990 (Ontario) s 130(e).
469 The term ‘disclosure document’ includes, among other things, a prospectus for the offer: Corporations Act 2001 (Cth) s 9.
for compensating anyone who has acquired securities and suffered loss as a result of an untrue or misleading statement (including an omission) in a prospectus.

Furthermore, it imposes civil liability on any person who fails to comply with s 81. That person is therefore liable for the payment of compensation to any person who has acquired securities of the kind in question and suffered loss in respect of them as a result of the failure to include the required information. However, civil liability under s 90 does not prevent other liabilities that may have arisen. Hence, parties liable for information contained in prospectuses in the UK include:

i. the issuers;

ii. directors at the time when the prospectus is submitted;

iii. each person who has authorised himself or herself to be named, and is named as a director;

iv. each person who accepts, and is stated in the prospectus as accepting responsibility for the prospectus/listing particulars or part thereof;

v. any other person who has authorised the contents, or any part of, the prospectus.

Section 90(8) of the FSMA’00 deals with the liability of promoters as follows:

No person shall, by reason of being a promoter of a company or otherwise, incur any liability for failing to disclose information which he would not be required to disclose in listing particulars in respect of a company’s securities — (a) if he were responsible for those particulars; or (b) if he is responsible for them, which he is entitled to omit by virtue of section 82.

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470 Financial Services and Markets Act 2000 (UK) c S.5, s 90(6).
471 Financial Services and Markets Act 2000 (UK) c 8, s 90(8).
Chapter 4: Civil Liability for Defective Prospectuses

In addition, under s 51(1) of the Companies Act 2006 (UK) (CA’06) promoters are responsible for pre-incorporation contract, deeds and obligations. However, in the UK, liability of promoters was established both under the common law of torts and under the liability provisions of company legislation. Promoters, lawyers and any person who has a separate certification in the prospectus can be held liable under English common law; the ratification or adoption, after the incorporation does not discharge the promoter from liability of contract.

The above shows that a statutory liability is imposed by developed countries on the issuers, promoters, directors, underwriters, issue managers and experts who can become liable to compensate each investor who, having relied on the defective prospectus, suffers loss or damage by investing in an IPO. In addition to statutory liabilities, those persons are also liable under the common law of torts.

However, the following will evaluate the Saudi civil liability for defective prospectuses in light of its equivalents in the selected developed countries.

4.6 Evaluation of Civil Liability Provisions for a Defective Prospectus in Saudi Arabia

4.6.1 Drawbacks of the Civil Liability Provisions

The preceding description of the civil liability provisions for a defective prospectus shows that the Saudi jurisdiction is in line with the selected developed countries. Both Saudi Arabia and developed countries impose civil liability for a defective prospectus.

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472 Section 51(1) of the Act provides that: ‘A contract which purports to be made by or on behalf of a company when the company has not been formed has effect, subject to any agreement to the contrary, as one made with the person purporting to act for the company or as agent for it, and he is personally liable on the contract accordingly’.

473 Benjamin v Wymond (1884) 10 VLR (Eq) 3 (the establishment of promoter’s liability).

Therefore, persons who are responsible for a defective prospectus are liable for compensation of investors who have sustained loss or damage as a result of defective disclosures in a prospectus. Hence, identifying who can be civilly held liable is crucial to the protection of investors.

The previous description of the civil liability regimes of the selected countries and Saudi Arabia shows that the issuers, directors, underwriters and experts are liable in these jurisdictions for defective prospectus. Moreover, the laws of these selected developed jurisdictions clearly impose civil liability on parties other than those stated in art 55 of the CML’03. For instance, promoters have been explicitly made liable in the developed countries’ laws.\textsuperscript{475} It can be also seen that there is uncertainty about whether the issue managers and lawyers fall within the ambit of this liability or not. Under Saudi law, the vague expression, ‘any person who has been mentioned in the prospectus and has certified any part of the prospectus will be exclusively liable for the part he/she certified’ can be seen.\textsuperscript{476} None of the above selected laws of the developed markets includes a similarly vague expression. They, instead, use a clearer expression than that of the law in Saudi Arabia. For example, the US and Canada impose civil liability on every person who signs the registration statement/prospectus; the UK clarifies that each person who accepts the responsibility for the prospectus/listing particulars, or part thereof, is civilly liable for a defective prospective in regards to the aggrieved investors. The UK law further imposes civil liability on the persons who authorised the content or

\textsuperscript{475} Functions of promoters and rational for their civil liability will be carefully discussed later in this chapter.

\textsuperscript{476} Capital Market Law 2003 (Saudi Arabia) art 55(b)(5) states: ‘Others identified in the prospectus, who have consented in writing to be so identified, as having certified the accuracy and truthfulness of the information stated in the prospectus; however, such person’s liability shall not extend to information in parts of the prospectus which are not so certified by him. That person shall be responsible for any part of the prospectus understood to have been prepared according to his statement and approval in his capacity defined under this paragraph.’ This is from the official translation from Arabic to English undertaken by the CMA, Saudi Arabia.
any part of the prospectus. The CA’01 imposes civil liability on persons named in the ‘disclosure document’\(^{477}\) with their consent as having made a statement, and any person who contravenes or is involved in the contravention of s 728(1).\(^{478}\) Bringing those four selected laws of developed countries together in the context of Saudi Arabia, art 55 of the CML’03 is ambiguous and weaker in respect of the civil liability of promoters, issue managers and lawyers. These drawbacks in the legal provisions produce weaker protection of investors in the disclosure regime in Saudi Arabia. The disclosure provisions contained in the CML’03 aim to develop the securities market, although, as some scholars have affirmed, this development has been negatively affected by the weaknesses of the protection of outside investors.\(^{479}\)

The roles played by the promoters and issue managers are important. They provide separate certification to the fact that they have examined the prospectus released to the public.\(^{480}\) The publication of their certificates will be included in the pertinent prospectus. Equally important, lawyers play a significant role in the corporate fundraising process. Lawyers are subject to civil liability, due to their involvement in the IPO process in other jurisdictions, as will be discussed later in this chapter. With respect to a prospectus, discussion of the roles of promoters, issue managers and lawyers and the rationale for their liability for a defective prospectus will be undertaken below.

\(^{477}\) The term ‘disclosure document’ includes, among other things, a prospectus for the offer: *Corporations Act 2001* (Cth) s 9.
\(^{478}\) Section 728(1) of the *Corporations Act 2001* (Cth) prohibits the disclosure of misleading or deceptive statements and non-disclosure of material fact in the prospectus.
4.6.2 Functions of Promoters and the Rationale for their Civil Liability for a Prospectus

Promoters have an essential role in starting a company.\textsuperscript{481} They are generally involved in setting up the corporation and starting up the business of the corporation.\textsuperscript{482} They have a fiduciary obligation and hence must act in good faith and avoid conflict of interest when promoting a company, including during the period before the company is registered. A company may have more than one promoter. Any person can be considered a promoter even if he/she has taken only a small part in the promotion proceedings.\textsuperscript{483} Despite a promoter being a founder of a company, he/she may or may not be the director of the company.

Professional people, such as lawyers, engineers, accountants, and bankers are not considered promoters while carrying out professional services through their involvement during the formation of a company.\textsuperscript{484} They must act purely in a professional capacity on behalf of a promoter.

In the Australian case of \textit{Tracy v Mandalay Pty Ltd},\textsuperscript{485} it was observed that the essential factual involvement in the promotion of the company can occur before or after incorporation. Chief functions associated with promoters include:

vi. negotiating of preliminary agreements;

vii. preparation of the company’s constitution;

viii. identifying prospective directors and shareholders;

\textsuperscript{481} The word ‘promoter’ has not been defined or mentioned anywhere in the \textit{Capital Market Law 2003} (Saudi Arabia) nor by the CMA.
\textsuperscript{482} Jason Harris, \textit{Corporations Law} (LexisNexis Butterworths, 3\textsuperscript{rd} ed, 2010) 35.
\textsuperscript{483} Ibid 36; See also, Susan Woodward, Helen Bird and Sally Sievers, \textit{Corporations Law in Principle} (Thomson Lawbook, 7\textsuperscript{th} ed, 2005) 138.
\textsuperscript{484} Woodward, Bird and Sievers, above n 483.
\textsuperscript{485} (1953) 88 CLR 215, 242.
ix. preparation of the company’s fundraising documents (for example, a prospectus);

x. raising capital, either before or after incorporation.486

Functions similar to the above are found in the Companies Law 1965 (CL’65) of Saudi Arabia.487 A promoter or company ‘founder’ is any person who starts the idea of incorporation and participates in the process of establishment a company.488 According to art 53 of the CL’65, ‘a founder of a corporation shall be any person who has signed its memorandum of association, or applied for an authorisation to incorporate it, or offered a contribution in kind upon its organisation, or actually participated in its organisation’.

The underlying principles for the promoter regarding civil liability are significant in order to ensure the integrity of the prospectus. Moreover, fiduciary duties to the company are the main obligation of a promoter. For instance, the New South Wales Supreme Court in Aequitas v AEFC decided that promoters have the duty to make full and complete disclosure to the company as well as to the initial shareholders.489 This shows that the promoters are responsible for wrongdoings that are against the interests of the shareholders. In addition, the fostering of investor protection against misconduct by promoters has long been considered under the common law.490

The civil liability of promoters for defective prospectuses is found in the selected developed jurisdictions. For instance, s 90(8) of the FSMA 2000 (UK), as stated above,

486 Jason Harris, Anil Hargovan and Michael Adams, Australian Corporate Law (LexisNexis Butterworths, 2nd ed, 2009) 250.
487 Companies Law 1965 (Saudi Arabia) arts 53–65.
488 Alghamdi and Hussinie, above n 66, 219.
489 (2001) 14 NSWSC 442.
clearly deals with the civil liability of promoters. Moreover, the CA’06 provides liability against promoters in the case of misstatement in the preparation of a prospectus. In Australia, s 1006 of the CA’01 clearly imposes civil liability on the promoter for false or misleading statement in, or omission from, a prospectus. In addition, s 711(2) and (4) of CA’01 requires the disclosure of the interests of the promoters of the company to be included in the prospectus. As a result, a promoter may be liable under s 729 of the CA’01 which imposes liability on any person named in the prospectus for failing to make the required disclosures.

In the US, liability extends to promoters who are required to sign the registration statement before the security could be offered for sale. Section 11 of the Securities Act imposes civil liability on every person who is a signatory to that statement.

All of the above demonstrates the importance of the liability of prospectus promoters, an importance which is in line with the interests of investors. Civil liability of promoters is significant for investor protection, especially, in the IPO market and the securities market at large. Thus, the liability of promoters turns out to be more attractive for recovery in the process of developing a prospectus civil liability regime in Saudi Arabia. This can be due to the fact that, ‘the essence of a promoter’s obligation is disclosure of matters relevant to investors’. Hence, the role of promoters is important in relation to the full, true and plain disclosure of information to potential investors. The absence of civil liability of promoters is a shortcoming of the prospectus civil liability regime; an omission that results in greater ambiguity than already exists in the Saudi disclosure regime. In comparison with the above selected developed countries, the

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491 Securities Act 1933 (US) § 7; 15 USC § 77g (1933).
promoters can be held liable under the securities statute and under the common law of torts. Investors can seek remedy through the rescission of their investment contract.

4.6.3 Functions of Lawyers and the Rationale for their Civil Liability for a Prospectus

A securities lawyer plays an important role in assisting a public company to meet its disclosure obligations.\textsuperscript{493} The lawyer’s central role is to verify and certify that full, fair and timely disclosures have been made in the prospectus. Legally, the lawyer’s duty is to ensure that the prospectus has been prepared in compliance with the relevant law. A lawyer provides legal advice and opinions to the issuer throughout the making of the prospectus. Therefore, lawyers (or the legal advisors of the company) guide the issuer before the corporation goes public, both in the preparation of a prospectus and during the IPO. In addition, lawyers have a duty to guide the issuer through various regulatory obstacles. The integrity of a legal framework regarding the role of lawyers imposes potential liability on them for providing incorrect legal advice to the issuer and attaching false certification to the prospectus regarding legal compliance. As with other experts involved in the prospectus, lawyers may not be held liable for sections of the prospectus that were not prepared by them. It is stated that every expert, ‘such as accountants, lawyers, appraisers or engineers, are best positioned to ensure the correctness of their opinions. However, they have no influence on the content of the parts of the disclosure not prepared by them’.\textsuperscript{494}


Arguably, it is said that lawyers are not generally regarded as experts in respect of the IPOs.\(^{495}\) This is because lawyers are not supposed to be experts regarding the entire content of the prospectus, but they are expected to have expertise on the legal aspects of the prospectus. For instance, inappropriate legal opinion regarding the tax status of the issuer may result in the lawyer being held liable for their specialist opinion in the prospectus.\(^{496}\) The involvement or participation of lawyers in any part of the prospectus should be enough for the imposition of civil liability on them.\(^{497}\) Furthermore, the role of the lawyer in the prospectus goes beyond advisory services to verify the fulfilment of the legal requirements of the prospectus content. By virtue of their position as lawyers, they have a duty to ensure compliance with the applicable regulatory requirements. Because of their legal expertise, the later stage involvement by lawyers in the process of preparation is much more than that of the auditor in attesting that the legal requirements for the prospectus have been met.\(^{498}\) Therefore, weaknesses and certain requirements regarding the prospectus have to be resolved by lawyers before it is released to potential investors. In this regard, Daines asserts that, ‘lawyers are likely to be influential in the firm’s incorporation decision, as they possess specialized legal knowledge and may have more at stake in the decision than other advisors’.\(^{499}\)


\(^{496}\) See *Schneider v Traweek*, Fed Sec L Rep 95, 419 (CCH 1990).

\(^{497}\) Under Californian securities law, an attorney who drafts the prospectus, or an offering circular, normally would face potential liability only for the attorney’s attributed expertise portions: see Marc I Steinberg and Chris Claassen, 'Attorney Liability under the State Securities Laws: Landscapes and Minefields' (2005) 3 *Berkeley Business Law Journal* 1, 40.

\(^{498}\) Beatty and Welch, above n 495, 549.

On the other hand, it is claimed that lawyers may help the issuer to commit fraud, particularly if the defective disclosure has gone public with the lawyers’ consent. This may be combined with the issuer’s desire to increase funds by ignoring their liability. Hazen claims that ‘[l]awyers, like anyone else, can violate the securities laws.’ However, lawyers have the right not to certify a defective prospectus. It is against their ethical and professional obligations. The advisory function of the lawyers does not require them to agree with client’s aims of maximising their economic interests. In addition, lawyers ‘exercise discretion in deciding’ on the content of prospectus disclosure to the public. However, legal advisors can be primarily held liable for defective disclosures in a prospectus. It can, therefore, be said that civil liability should be imposed on lawyers too. On the basis of the above evidence, the imposition of civil liability on lawyers is imperative for the protection of investors in the primary market in Saudi Arabia.

4.6.4 Functions of Issue Managers and the Rationale for their Civil Liability for Prospectus

The issue manager plays a significant role in the IPOs. The issue manager advises the issuer on issue size and the timeliness of subscription management, as well as on all administrative and legal procedures. The issue manager also takes responsibility for: the preparation of the prospectus; the assurance of a clear prospectus; and marketing the shares to the public. The issue manager is most responsible for assisting the issuer in

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504 See Breard v Sachnoff & Weaver Ltd, 941 F 2d 142 (2nd Cir, 1991); Molecular Technology Corp v Valentine, 925 F 2d 910 (6th Cir, 1991) 913–14, 917–19.
Chapter 4: Civil Liability for Defective Prospectuses

drafting the prospectus.\textsuperscript{505} A ‘due diligence certificate’ is required to be provided by the managers; this declares that the prospectus contents are accurately disclosed to the public.\textsuperscript{506}

The prospectus liability provisions of Saudi Arabia do not have a clear liability imposition on the issue manager. Managers, as a minimum, ought to be liable for their participation in the disclosures made in a prospectus. This is also because of the great deal of performance of due diligence required from lead managers for the offering.\textsuperscript{507}

There are a number of reasons that the civil liability should be imposed on managers. For example, ‘managers should be liable for getting involved in the preparation of prospectuses, providing confirmation of the fairness and adequacy of the disclosures, controlling their issuers, as well as other participants in an IPO coalition’.\textsuperscript{508}

The imposition of civil liability on the issue managers is clearly found in the \textit{Securities Act 1933} of the United States.\textsuperscript{509} Section 12(2) of the \textit{Securities Act 1933} imposes liability in general on any person who is involved in the defective disclosure. This section is unlimited in relation to liability for the prospectus and has a broader extent of application than that of § 11.\textsuperscript{510}

\textsuperscript{505} Hanley and Hoberg, above n 365, 2852.
\textsuperscript{506} The ‘due diligence certificate’ is required under regulation 14 of the \textit{Securities and Exchange Commission (Merchant Bankers and Portfolio Managers) Regulations 1996}. For an example of such certificate, see the prospectus issued by the Alligator Energy Limited in November 2010 <http://www.alligatorenergy.com.au/alligator_energy_prospectus_lr.pdf> 114.
\textsuperscript{508} Solaiman, ‘Investor Protection and Civil Liabilities for Defective Prospectus’, above n 480, 521.
\textsuperscript{509} The manager falls under the ambit of the liability imposed on every underwriter as underwriting manager. See, § 11(a)(5) of the \textit{Securities Act 1933} (US); 15 USC 77k(a)(5) (1933).
\textsuperscript{510} Shulman, above n 274, 243.
Chapter 4: Civil Liability for Defective Prospectuses

In the US court of appeals, it was held that a person is liable for omissions from or misstatements in a prospectus if his/her involvement is significant in the IPO.\textsuperscript{511} Courts have found issue managers liable in regard to their support and help in relation to the violation of disclosure requirements when they intentionally and significantly aid the violation.\textsuperscript{512} Moreover, investors may reasonably rely on the reputation of the issue managers in making their investment decision.\textsuperscript{513} Thus, the issue managers become civilly liable for the defective prospectus.

In view of the above reasons, it is evident that the issue manager has an important role to play in the offering of securities for which civil liability has been imposed by the US laws. In Saudi Arabia, calls have been recently made for a strong regulation to deal with the considerable ambiguity that exists in relation to disclosures in a prospectus made by issue managers.\textsuperscript{514} Issue managers are responsible for the lack of information during the process of the IPOs, which can negatively influence the public investment decision.\textsuperscript{515} Consequently, it can be said that the Saudi disclosure regime needs to deal with the lead managers’ civil liability arising from a defective disclosure. The absence of civil liability for issue managers is certainly detrimental to the protection of the investor. To this end, the imposition of civil liability on issue managers is imperative to protect the IPOs participants.

\begin{footnotesize}
\begin{itemize}
\item [511] Stokes v Lokken, 644 F 2d 779 (8\textsuperscript{th} Cir, 1981) 785.
\item [513] See \textit{In re- Gap Stores Sec. Litig}, 79 FRD 283 (ND Cal, 1978), 299.
\item [515] Ibid.
\end{itemize}
\end{footnotesize}
4. 7 Considering Arguments against the Extension of Civil Liability to Every Person Who Participated in the Preparation of a Prospectus

It may be argued that the imposition of civil liability on the promoters, lawyers and issue managers will discourage their participation and accordingly decrease the number of new offerings to the public.\textsuperscript{516} This argument may be correct in terms of high risk and high technology industries that have a higher need for specialist knowledge and a higher risk of adverse consequences. The ability to assess the risk associated with the IPOs requires sophisticated investors. Furthermore, it is believed that the complexity of the industry makes it hard for potential investors to make an informed decision based on information provided in the prospectus. Thus, it is clear in the case of \textit{Klein v Computer Devices Inc},\textsuperscript{517} in which the prospectus failed to disclose technical reasons for which the main product of the issuer was considerably unprofitable. Mistakes in a prospectus, which are difficult for a professional to identify, will be practically impossible for the general investor to notice. Klinges states that, ‘a prospectus is difficult enough for the average investors to understand’ and what is more, the ‘technical language about an issuer’s industry may intensify this problem’.\textsuperscript{518} It can be suggested that avoidance of investing in high risk IPOs is favourable, especially if the nature of risk is difficult to establish.

In Saudi Arabia, the majority of share market investors lack the ability to assess whether the prospectus of a company is ‘good’ or ‘bad’. Generally, investors usually assume that the company procedures of going public and its prospectus are done in accordance with

\begin{footnotesize}
\textsuperscript{516} Solomon in his thesis has also brought up this argument. For more details, see Solomon, ‘Investor Protection in a Disclosure Regime’, above n 352, 228.
\textsuperscript{517} 591 F Supp 270 (SDNY 1984).
\end{footnotesize}
Chapter 4: Civil Liability for Defective Prospectuses

law. However, the fact is that companies with weak economic fundamentals have been found to be taking advantage of innocent investors and have raised enormous funds as a result, but at great risk to the funds of those investors, is a concern. These companies have been struggling in the market because of their weak performance. Such investor experiences reduce their confidence and their willingness to participate in new offerings. A random sample of 242 Canadian firms, taken from IPOs issued between 1987 and 1991 and the gathering of data directly from the IPO prospectuses found that companies supplying accurate prospectus information would be more likely to endure for a longer time in the market and be able to reissue equity in the market over the longer term. Moreover, a recent empirical study found that, companies with greater ambiguity in their offering prospectuses ‘experience higher underpricing at the IPO’.

In 2006, the Saudi IPO market sharply declined and many companies failed to go public because of the lack of investor confidence in the share market. A recent report by the SSE shows that in 2008, the market of IPOs witnessed a significant fall in number issued of 50 per cent of the total number of IPOs in the previous year. It represented a huge decline in the proportion of IPOs subscribed since the CML’03 and CMA

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519 More than 35 listed companies in the SSE (representing 23 per cent of the market listed companies) are facing the risk of suspension of trading, termination or liquidation. See Ibrahim Saleh Aldossary, 'Losses Threaten to Stop Trading of 23% of Listed Companies', Aleqtisadiyah (online), 31 March 2012 <http://www.aleqt.com/2012/03/31/article_641654.html> [Arabic].
520 Ibid.
regulations came into effect. The fact is that the IPO market has become unattractive for general investors because they feel unprotected in the market, even with the recent regulation of the market.\textsuperscript{525} The Technical Committee of IOSCO believes that, in the new economy, the preservation of investor confidence in the IPO process is of particular importance for investors and market professionals.\textsuperscript{526}

Therefore, it is thought that the fear that dominates the market and the poor protection of investors have had a negative effect on participation in the ‘good offers’. However, prospectuses with a high risk or technical terms will be more desirable to the average investor once such prospectuses are coupled with a strong liability regime imposed on the persons involved in formulating the content of the prospectus. For instance, Fox declares that ‘the potential liabilities imposed upon an underwriter in connection with the public offering of securities create a strong incentive for the underwriter to uncover some of this information and disclose it to the market’.\textsuperscript{527}

Indeed, inefficient protection of investors in the IPO market will lead to the weakening of corporate fundraising of new companies with strong economic fundamentals, and the local economy will be disadvantaged accordingly. Generally, investor protection is imperative in order to have a sustainable and successful securities market. Thus, the imposition of civil liability on all persons involved in the preparation of a prospectus

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\textsuperscript{525} Steve Drake, 'Another Weak Year for IPOs in the GCC as Issuers and Investors Remain Wary of Volatility in the Capital Markets', Zawya (online), 14 February 2012 <http://www.zawya.com/story/ZAWY20120214063055/Another_weak_year_for_IPOs_in_the_GCC__PwC/>.


Chapter 4: Civil Liability for Defective Prospectuses

will provide greater protection for the investors and create greater deterrence for potential wrongdoers in Saudi Arabia.\textsuperscript{528}

4. 8 Summary and Conclusions

One of the major objectives of the CML’03 and the CMA regulations is to ensure the protection of investors in the securities market. Yet the disclosure regime is in need of further improvements to be in line with that in the developed markets. The preceding discussion reveals that the civil liability provisions dealing with defective prospectuses in Saudi Arabia are ambiguous when compared with other equivalent provisions from selected developed countries, such as the US, the UK, Australia and Canada. This flaw has been measured in relation to the scope of civil liabilities. The discussion shows that the civil liability of promoters, lawyers and issue managers for the prospectus is obscure in the current CML’03 liability provisions. The combination of the serious dearth of case law and absence of the interpretation by courts has considerably contributed to the ambiguity of civil liability regarding a defective prospectus. The importance of the imposition of civil liability on those professionals, and their significant roles in the preparation of the prospectus, have been analysed earlier. The lack of clarity regarding civil liability of those persons who are not specifically mentioned in the prospectus civil liability provisions would generate uncertainty in relation to the law concerned.

Furthermore, the earlier discussion suggests that the requirements of the prospectus may call for improvements in order to increase the transparency level in the market. It is essential that the regulator take an effective role in improving the prospectus

\textsuperscript{528} Remedies available to investors and defences under the civil liability provisions for defective disclosures will be discussed in a separate chapter. In addition, two individual chapters will discuss the judicial enforcement and administrative enforcements of the civil liability provisions in Saudi Arabia.
requirements in line with those of selected developed countries. An effective verification process is imperative to determine what information may be material. Having such a process in place will ensure accurate disclosures in the prospectus.

Consequently, it can be said that civil liability for defective prospectuses in Saudi Arabia is inadequate. Thus, it can be confirmed that the investor protection in the IPO market in Saudi Arabia is weaker than that in selected developed markets. It can be suggested that the securities regulators must focus on the interest of investors rather than remaining silent, which behaviour is contrary to their main function, namely to protect investors from illegal and unfair practices in the market. Oakes and MacNeil clearly stress that, ‘the main purpose of the Securities Act in connection with public offerings is to provide investors with “full and fair disclosure”’. 529

Moreover, remedies available to victims of defective prospectus and defences against the civil liability will be discussed in the later stages of this thesis. 530 However, prior to a discussion on remedies and defences, the next chapter will investigate the legal requirements that govern disclosure in the secondary market and the provisions of civil liability resulting from the breach of the disclosure requirements. It will discuss the contravention of disclosure requirements for the periodic disclosures and continuous disclosures in Saudi Arabia.

530 Chapter 6 will discuss investors’ remedies against the breaches of the disclosure regime under Saudi securities laws; and Chapter 7 will discuss defences and evidence in regard to civil liability for defective disclosures under Saudi securities laws.
CHAPTER 5: CIVIL LIABILITY FOR DEFECTIVE DISCLOSURES IN THE SECONDARY MARKET UNDER SAUDI SECURITIES LAWS: CONTINUOUS DISCLOSURE AND PERIODIC DISCLOSURE

5.1 Introduction

The secondary market is a place where investors can purchase a security from another investor rather than the issuer. This market provides a trading facility for both equity and the debt securities. Thus, the rights of investors need to be protected, and laws and regulations are needed to foster public confidence, market integrity and economic prosperity. In the secondary market, greater disclosure is vital to market sustainability. Fox claims that greater disclosure will have three benefits, namely: ‘(1) the market will be a fairer place in which to invest; (2) the market will be a less risky place to invest; and (3) resources will be allocated more efficiently’. However, greater disclosure needs to be combined with an effective disclosure regulatory framework.

The aim of this chapter is to examine investor protection in the Saudi secondary securities market. Accordingly, an examination of the civil liability regime for the secondary market will be conducted throughout this chapter which will discuss the legal requirements that govern disclosure in the secondary market. Disclosure-based regulation is generally regarded as the optimal policy, especially in the most developed securities markets, such as the four selected in this thesis. The obligation to disclose information is essentially connected with liability for defective disclosures. Hence, an
analysis of the civil liability for defective disclosures in the secondary market will begin with the requirement for disclosure. This chapter will look at the provisions dealing with defective continuous and periodic disclosures, as they have different criteria and functions. This will be in accordance with selected developed countries such as the US, the UK, Australia and Canada.

As mentioned above, the requirement for information disclosure is closely associated with the liability for misstatement liability made during the course of the disclosure. Therefore, a description of the requirements for periodic and continuous disclosures is essential to determining whether the Saudi securities market has sufficient requirements concerning secondary market disclosure. Significantly, civil liability for defective disclosure is governed by the Capital Market Law 2003 (CML’03) provisions. Therefore, legal analysis will be carried out by the present writer to examine the inadequacy of, and loopholes in, the current secondary market civil liability regime in Saudi Arabia in regard to both periodic and continuous disclosure.

To this end, this chapter is divided into nine sections: Section 1 provides an introduction and section 2 explores the objectives of disclosure in the secondary market. Section 3 provides the legal requirements related to continuous disclosure to the Saudi Stock Exchange (SSE). Section 4 presents the legal requirements related to periodic disclosure to the SSE. Section 5 focuses on the objectives of civil liability for defective disclosure in the secondary market. Section 6 provides the provisions governing the civil liability for defective disclosures in the Saudi secondary market. Section 7 discusses the civil liability provisions contained in articles 56(a) of the CML’03 and 10(a)(c) of Market Conduct Regulation 2004 (MCR’04) and their applicability to defective continuous disclosures. Section 8 discusses articles 56(a) and 10(a)(c) and their applicability to
defective periodic disclosures. Section 9 provides a summary and conclusions, including that the civil liability regime for secondary market disclosure is contrary to the disclosure philosophy of investor protection.

5.2 The Objectives of Disclosure in the Secondary Market

Transparency is one of the essential principles to be promoted by regulations in the secondary market. This is because transparency is one of the most efficient mechanisms to protect the interests of investors in public companies. The main objective of mandatory disclosure in the secondary market is to avoid information misstatements, which mislead investors in their investment decision making. Investors may thus suffer loss or damage because of false or misleading statements. As a result, in order to maintain investor protection, companies have to publish both positive and negative information. Publishing information is undertaken by listed entities through continuous disclosure and periodic reports.

It is important for an efficient capital market that the market value reflects the true value of the securities. An efficient market hypothesis (EMH), developed by Fama in the 1970s, claims that share prices at any time reflect available information. A recent study in secondary market disclosure finds that sources of information lead to an adjustment of stock price towards its fundamental value. In addition, compliance with mandatory continuous disclosure leads to more timely price discovery. Another study

535 IOSCO, 'Objectives and Principles of Securities Regulation-2010', above n 18, 12.
537 Fama, 'Efficient Capital Markets', above n 12.
539 Ibid 3.
confirms that mandatory continuous disclosure is significant in the deterrence of secondary-market price distortions. Transparency in financial disclosures is crucial to avoid unexpected market crashes. Greenspan, for instance, affirmed that improvements in the disclosure regime would be significant in decreasing the risk of future financial crises. Consequently, it can be said that investor protection is an important objective of the disclosure in the secondary securities market.

### 5.2.1 The Importance of Disclosure in the Saudi Secondary Securities Market

Having full, true and timely disclosure in the secondary market is significant for the integrity of the market and accordingly investor protection. The low level of disclosure and transparency in the secondary securities market is the main reason that led to a loss of confidence in the Saudi stock market. Therefore, the domestic securities market has become extremely unattractive to investors instead of being a ‘honey pot’ or ‘magnet’ for the development of savings.

In Saudi Arabia as elsewhere, a high level of transparency can prevent the emergence of speculation that is built on the basis firstly of unreliable information that prompts trades intended for profit but that might not only mean individual loss due to the nature of the information but contribute to a ‘boom-bust’ cycle and widespread market loss; or secondly on the basis of information that is not available to others that is exploited by those ‘in the know’ in order to have an immediate profit, contributing again to loss — this tie by others but ultimately also a loss of confidence in the market and a further

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541 For example, the Hong Kong Government has proposed giving regulators the power to fine companies up to HKD 8 million (USD 1.3 million) if they do not quickly disclose information that could affect stock prices. Li Tao, 'Market Regulators to Enforce Disclosure Rules', China Daily Clips (online), 27 July 2010 <http://www.cdeclips.com/en/hongkong/fullstory.html?id=48523>.
ultimately downward spiral due to loss of confidence in the market and an even more profound unwillingness to invest, thus depriving the economy of necessary funds for development.

By contrast, adequate disclosure in the secondary market will stop leakage of internal information of companies, thereby achieving efficiency in performance in the market. No investor can without transparency be assured that they received a fair price for the buy and sell orders in the market. This generates a loss of trust in the market and an unwillingness to invest. In the securities market, it can be clearly said that the stronger transparency, the fewer the rumours and the less the information asymmetry in the market — and the greater the possibility of trust and subsequent investment in the market, the more rational the decision making process of the investor, and ultimately the movement of the market as it reacts to actual rather than inaccurate information. This is important for domestic and foreign investors alike, with obvious repercussions for investment — and thus further and diversified development — in Saudi Arabia.

The above evidence shows the indisputable significance of disclosure in the secondary market. True market value and investor confidence are significant objectives of disclosure in the secondary market. Accordingly, it can be clearly seen that a sufficiently robust disclosure regime for the secondary market is essential for the purpose of investor protection.

To this end, the legal requirements for disclosures in the secondary market in the Saudi Stock Exchange (SSE) will be discussed below. Firstly, the author will attempt to discern the scope and definition of continuous disclosures and periodic disclosures. Secondly, the legal requirements for both continuous and periodic disclosures will
discussed in order to find out whether these requirements favour investor protection or not.

5.3 Continuous Disclosure Requirements in the Secondary Market

This section intends to define continuous disclosure in the secondary securities market in general. Then, it will determine whether the Saudi laws recognise the concept or not. In addition, this section will outline every legal requirement for continuous disclosure under Saudi securities laws in order to analyse them by comparing them with their equivalent securities regulations in selected developed countries.

5.3.1 The Scope of Continuous Disclosure

5.3.1.1 Meaning of Defective Continuous Disclosure

A listed company has an obligation to continuously disclose information which may have an effect on its market price or value. Continuous disclosure is based on the EMH that ‘all investors should have equal and timely access to information about a company’.

The necessity for securities markets to be fully informed at all times is undeniable. It is essential to maintain the integrity of financial markets to protect the funding attained through market exchange and on which companies are greatly reliant. As a result, a company’s obligation to disclose material information is essential for fair share pricing in financial markets.

Keeping this in mind, it is often said that a strong and clear civil liability for disclosure violations in secondary markets is essential for investor protection. Moreover, this section intends to discover who can be held civilly liable for defective continuous disclosure under CML’03 and the CMA regulations.

The main aim of this section is to examine the question of whether the civil liability regime for defective continuous disclosure in Saudi Arabia is sufficient or not. In order to respond to this question, several steps need to be considered. Firstly, it is necessary to attempt to outline the differences between periodic disclosure and continuous disclosure. Then, evidence of the importance of continuous disclosure is provided. After that, a discussion is carried out to discover whether continuous disclosure obligations exist in Saudi law or not. Finally, there is discussion about whether civil liability provisions are present and, if so, whether they are sufficient. In addition, there is an attempt to identify those persons who can be held liable for defective continuous disclosures.

5.3.1.2 Difference between Periodic Disclosures and Continuous Disclosures

In a well-functioning securities market, continuous disclosure is imperative to ensure that investors are accurately informed in a timely manner. Therefore, under the ‘continuous disclosure’ obligations, listed companies have an obligation to continually provide to the market all material information that could affect investors in their decision-making. Listed companies, therefore, are required to disclose to the public any information that a reasonable person would expect to have a material effect on the share price or value. A disclosing entity is required to notify the market operator of

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information about specified events or matters as they arise so the market operator makes that information available to investors. On the other hand, periodic disclosure is structured financial information; for example, the quarterly, half-yearly or preliminary final reports.

Issuers are responsible for ongoing market disclosure. This is due to the fact that, ‘the primary idea behind continuous disclosure is to provide price-sensitive information to the market as soon as it is known to the issuer of securities’. For that reason, it is often said that ‘firm value is discovered by timely disclosure, particularly between periodic reports’.

In developed securities markets, trends toward continuous disclosure have become evident. For example, the US adopted changes in disclosure regulations, requiring a shift from periodic to continuous disclosure. It imposes a requirement on listed companies to broadly disseminate certain information to the public on a continuous basis rather than periodically. In the same context, in 2002, Canadian legislation embodied a shift to additional monitoring disclosure standards. It enables the Ontario Securities Commission and other regulators to devote more resources to continuous disclosure.

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545 See Roman Tomasic, Stephen Bottomley and Rob McQueen, Corporations Law in Australia (Federation Press, 2nd ed, 2002) 145.
547 Mark Russell, above n 538, 1.

171
market disclosure monitoring.\textsuperscript{550} In Australia, disclosure of price sensitive information on a timely basis is required under the Continuous Disclosure Regulation (CDR).\textsuperscript{551}

5.3.1.3 The Importance of Continuous Disclosure in Relation to Investor Protection

Continuous disclosure is important for the integrity of the securities market. This is due to the fact that ‘continuous disclosure deals with the aggregate real and potential financial impact upon a listed entity as it is likely to be reflected in its securities’.\textsuperscript{552} In the EMH and the voluntary/mandatory disclosure debate, continuous disclosure has always occupied a significant place. The EMH states that efficient securities markets incorporate information into share prices immediately, rationally and without prejudice.\textsuperscript{553} Share prices move in a ‘random walk’ according to the accessibility of new information, and do not ‘stick to a pattern’.\textsuperscript{554}

Furthermore, information becomes more valuable in market investment decisions. Continuous disclosure aims to increase the level of information dissemination to all investors and keep them ‘up to date’. Furthermore, mandatory continuous disclosure contributes to the avoidance of unequal possession of information among investors.\textsuperscript{555} As a result, full, timely and accurate information is significant for the purpose of protecting investors from unfair market practices. In robust securities markets it is

\textsuperscript{550} Continuous disclosure requirements in the US, the UK, Canada and Australia will be mentioned and discussed later in line with the equivalent legal requirements in Saudi Arabia.

\textsuperscript{551} The CDR is comprised of s 674 of the Corporations Act 2001 (Cth) and ASX Listing Rule 3.1.


\textsuperscript{553} Fama, 'Efficient Capital Markets', above n 12.


believed that companies maintaining a higher level of disclosure could improve investor protection.  

A recent study finds that disclosure standards have a significant impact on the information environment. Sarra points out that, ‘an issuer’s continuous disclosure record allows regulators to make informed choices under risk assessment policies as to where to direct their monitoring and enforcement resources most effectively in the market.’ Although continuous disclosure has a number of opponents, research on the securities market demonstrates that, ‘a mandatory environment of continuous disclosure is necessary for the financial markets’. Fama has classified the ‘strong form’ efficient market, implying that all information, whether public or private, is fully reflected in the value or price of the share in the market. Therefore, actual regulation and its efficient enforcement play a crucial role in the process of any evaluation of the adequacy of continuous disclosure.

5.3.2 Requirements for Continuous Disclosure

The securities laws impose legal requirements for continuous disclosure on companies listed on the stock market. Hence, the following section will highlight the legal

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558 Sarra, above n 549, 74.
559 Some commentators argue that mandatory disclosure system has a number of costs: see Frank H Easterbrook and Daniel Fischel, ‘Mandatory Disclosure and the Protection of Investors’ (1984) 70 Virginia Law Review 669, 705.
requirements for continuous disclosures in selected developed jurisdictions (the US, the
UK, Australia and Canada) and under the Saudi securities laws.

5.3.2.1 Requirements for Continuous Disclosure in Developed Countries

In the US, continuous disclosure obligations are set out in Form 6-K and Form 20-F
pursuant to the Securities Exchange Act 1934 (SEA’34). The Sarbanes-Oxley Act 2002
(SOX’02) provides requirements for ongoing disclosures. Section 13 of the SEA’34
concerns periodical and other reports. This section was amended by § 409 of the
SOX’02 by adding a provision requiring ‘real time issuer disclosure’. The amendment
obliges the issuer to ‘disclose to the public on a rapid and current basis such additional
information concerning material changes in the financial condition or operations of the
issuer’. Moreover, the New York Stock Exchange Manual (the NYSE Manual)
impose further obligation on the listed companies concerning continuous disclosure. For
example, s 202.06 of the NYSE Manual contains the immediate release policy provision
requiring certain important information to be immediately released to the public. In the
US securities’ fraud cases the Market Model based event study (MMBES) has been a
required module of any calculation of damages. The MMBES is commonly used in the
US case law in order to measure the actual loss in the stock value as a result of the
breach of the continuous disclosures requirements. In SEC v Texas Gulf Sulphur Co, the
Court affirmed the principle of access to information for investors that ‘all investors
trading on impersonal exchanges have relatively equal access to information’.

563 Also known as the ‘Public Company Accounting Reform and Investor Protection Act’ and 'Corporate
and Auditing Accountability and Responsibility Act' and more commonly called Sarbanes-Oxley, Sarbox
564 Sarbanes-Oxley Act 2002 (US) § 409.
In Australia, s 674 of the Corporations Act 2001 (Cth) (CA’01) imposes continuous disclosure obligations on a company. In addition, Listing Rule 3.1 of the ASX is central to the integrity of the financial market. It aims to ensure timely and equal access to information by all investors. Listing Rule 3.1 requires listed entities to immediately disclose to the ASX any information that can be reasonably expected to materially affect the price or value of the entities’ securities upon the entities becoming aware of the information (also referred to as ‘price-sensitive information’), subject to certain exceptions. The Court of Appeal of the Supreme Court of New South Wales in James Hardie Industries NV v ASIC, noted that ‘The continuous disclosure regime, contained in s 674 and the Listing Rules, is designed to enhance the integrity and efficiency of Australian capital markets by ensuring that the market is fully informed’.

In Australia, the basic principle underlying the continuous disclosure framework is that:

Timely disclosure must be made of information which may affect security values or influence investment decisions, and information in which security holders, investors and ASX have a legitimate interest.

The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth) (‘CLERP 9’) focuses on transparency and open communications; continuous disclosure and disclosure rules (sch 6 and 7); financial reporting; audit reform (sch 1) and auditor independence and enforcement. CLERP 9

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568 ‘Timely’ disclosure is disclosure that is neither premature nor late; see Introduction to the Listing Manual (22 May 2011) <http://www.asxgroup.com.au/media/PDFs/introduction.pdf> 2.
569 Ibid.
has brought enhancements to the CA’01 in relation to the civil liability for continuous disclosure. 571

In Canada, s 75 of the Securities Act 1990 (Ontario) (SA’90) requires the reporting issuer to promptly disclose any material change that would have an effect on the security purchaser or seller. 572 In 2004, Canada’s securities regulators implemented a new rule for continuous disclosure requirements as found in the National Instrument 51-102 Continuous Disclosure Obligations (NI 51-102). 573 The NI 51-102 defines material change as ‘a change in the business, operations, or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer’. 574

In the UK, s 118C(6) of the Financial Services and Markets Act 2000 (UK) (FSMA’00) deals with ongoing disclosure in the market. It provides that ‘information would be likely to have a significant effect on price if it is information of a kind that a reasonable investor would be likely to use as a part of the basis of his investment decisions’. 575 In addition, Rule 6 of the Disclosure and Transparency Rules 2006 (DTR’06) 576 of the Financial Services Authority (FSA) imposes continuing obligations on the issuer and


571 These enhancements were in the form of amendments that provide an extension to civil liability for continuous disclosure and for proportionate liability, rather than joint and several liabilities in respect of misleading or deceptive conduct. See Sarra, above n 549, 122.

572 In addition in Canada, s 85 of the Securities Act 1996 (British Columbia) requires the reporting issuer to provide disclosure of a material change and other prescribed disclosure.


574 National Instrument 51-102 Continuous Disclosure Obligations 2004 (Canada) s 1.1.

575 See Robert Falkner and Jon Gerty, 'Regulation of Market Misconduct in the United Kingdom' (2006) 6 Journal of Investment Compliance 35, 40; Also, see Financial Services and Markets Act 2000 (UK) s 118C(6).

576 The DTR was published by the Financial Services Authority (FSA) in 2006, and covers companies admitted to the main market of the London Stock Exchange.
relevant persons as defined by the Act\textsuperscript{577} to provide information to not only the FSA but also shareholders.\textsuperscript{578}

The above description of continuous disclosure requirements shows that the US, the UK, Canada and Australia have robust securities markets coupled with well-developed regulations, reflecting a recognition by these countries of the importance of continuous disclosure requirements. It alludes to a positive signal of legislator responsiveness to demands in the securities markets for greater transparency and accountability. Recent updates in relevant legislation and regulation in regard to information disclosure and related matters reflect the ongoing commitment to achieving the best outcomes for shareholders in securities markets in terms of investor protection. In this section, an overview of these regulations regarding continuous disclosure obligations will be useful in order to determine the position of the continuous disclosure requirements in Saudi Arabia.

5.3.2.2 Requirements for Continuous Disclosures under Saudi Laws

The Saudi securities laws impose continuous disclosure requirements on listed companies. Listed companies are required to disclose material information continuously to the public. Article 46 of the CML’03 states that:

\begin{quote}
A party who issues securities must inform the Authority in writing upon becoming aware of any material developments which may affect the prices of the Securities issued by such party. If such a party has a Security traded on the Exchange, the Exchange must be informed of such developments in writing.
\end{quote}

\textsuperscript{577} See, eg, DTR 6.3.1 which refers to the issuer or person who has ‘applied, without the issuer’s consent, for the admission of its transferrable securities to trading on a regulated market’. The term ‘person’ here refers to (in accordance with the \textit{Interpretation Act 1978} (UK)) any person, including a body of persons corporate or unincorporated (that is, a natural person, a legal person and, for example, a partnership, but not including a limited liability partnership): see Financial Service Authority, \textit{Glossary Definition} (30 October 2012) <http://fsahandbook.info/FSA/glossary-html/handbook/Glossary/P?definition=G869>.  


177
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

As a result, listed companies have to inform the CMA and the public about any specific events, matters and major developments that fall under the scope of the company activities.\(^{579}\) ‘Continuing Obligations’ is the title of Part 6 of the *Listing Rules 2004* (Saudi Arabia) (LR’04). Under this part, art 25 specifically requires the issuer to disclose major developments. It obliges the issuer to notify the CMA and the public of any major developments that are not public knowledge and may lead to substantial movement in the price or significantly affect the issuer’s financial position.\(^{580}\)

‘Major developments’, as mentioned in the LR’04, are those that may have an effect on the company’s assets and liabilities or financial conditions or on the general course of its business.\(^{581}\) In addition, these major developments may lead to substantial movements in the price of the listed securities or, in the case of an issuer with debt instruments listed, lead to substantial movement in the price of its listed securities, or significantly affect its ability to meet its commitments.

Furthermore, art 7 of the MCR’04 provides a continuous disclosure obligation. The Article’s title is ‘Prohibition of Untrue Statements’.

A person is prohibited from making an untrue statement of material fact verbally or in writing or from failing to make a statement required to be made under the Capital Market Law, the Implementing Regulations, or the rules of the Exchange or the Depositary Centre, if the statement is made, or the person fails to make the required statement, for the purpose of influencing the price or value of a security, inducing another person to purchase or sell a security, or inducing him/her to exercise or refrain from exercising rights under a security.

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579 It states: ‘An issuer must notify the Authority and the public without delay of any major developments in its sphere of activity which are not public knowledge and which may have an effect on the issuer’s assets and liabilities or financial position or on the general course of its business and which may:

1) Lead to substantial movements in the price of the listed securities; or

2) In the case of an issuer with debt instruments listed, lead to substantial movement in the price of its listed securities, or significantly affect its ability to meet its commitments.’


581 *Listing Rules 2004* (Saudi Arabia) art 25 (b).
Article 7 falls under Part 4, which is titled, ‘Untrue Statements’. It is understood that this Article deals with continuous disclosure. However, it can be said that it is unclear. The term ‘person’ is general and ambiguous, as is discussed later in this section. Article 7 reflects the approach adopted by the Saudi securities legislator, that is, to prevent market misconduct by prohibiting untrue statements.

However, Saudi law, similarly to that of the preceding developed countries, shows that art 46 of the CML’03 and art 25 of the LR’04 have recognised the continuous disclosure obligation; this is considered a healthy approach in regard to having legal requirements governing continuous disclosure in the secondary market.

The materiality of information is the main concept of continuous disclosure. In Australia, for instance, a company discharges these obligations by releasing information to the ASX in the form of an ASX release or disclosure in other relevant documents. As a result, the market is kept fully apprised of information that may have a material effect on the price or value of the company’s securities and correct any material mistake or misinformation in the market. The Australian law empowers the ASX to enforce the listing rules. For example, in TNT Australia Pty Ltd v Poseidon Limited (No 2), the court confirmed the right of the ASX to enforce the ‘spirit’ of the listing rules by demanding greater disclosure.

Regulatory provisions in Saudi Arabia make similar provisions, with selected regulations developed in relation to the function and meaning of continuous disclosure. The Saudi regulatory definition of ‘continuous disclosure’ is that the issuer has to notify the CMA of any major developments that would have an effect on the market price or

582 See Baxt, Black and Hanrahan, above n 419, 227.
583 TNT Australia Pty Ltd v Poseidon Limited (No 2) (1989) 15 ACLR 80, 85.
value of the issuers’ shares. These major developments involve all information that is related to the company’s financial performance, operations and future expectations that would have an effect on the value of share prices. Therefore, it can be seen that the Saudi regulator has identified the need for continuous disclosure and required listed companies to comply with such a requirement.

However, art 7 of the MCR’04 demonstrates a degree of ambiguity in regard to who is responsible for continuous disclosure.584 The absence of clear specification of persons who are lawfully obliged to comply with the ongoing disclosure requirements creates confusion when determining who can be held liable. In contrast, the developed countries cited above clearly specify that the issuer is the person responsible for complying with the continuing disclosure obligations. The UK legislation, holds liable — in addition to the issuer — persons including a natural or a legal person.585 The Saudi provision in art 7 of MCR’04, arguably, excludes a company when the provision ‘him/her’ is used. Moreover, art 7 of the MCR’04 applies to all statements required to be made under the CML’03 and other market regulations. As a result, it can be said that the prohibition here presented applies to statements in periodic and continuous disclosures. The duality and ambiguity of this Article could lead to misinterpretation of the difference between periodic and continuous disclosure obligations by listed companies in the SSE. However, it is to be hoped that requirements for continuous disclosure are presented and differentiated from periodic disclosure requirements in the Saudi disclosure regime. This trend is in favour of a strong disclosure regime.

584 Article 7 of the Market Conduct Regulations 2004 (Saudi Arabia) states that, ‘A person is prohibited from making an untrue statement of material fact verbally or in writing or from failing to make a statement required to be made under the Capital Market Law, the Implementing Regulations, or the rules of the Exchange or the Depository Centre…’. For comprehensive information regarding the various rules of the SSE, recourse can be made to the CMA website <http://www.cma.org.sa/En/Pages/home.aspx>.

585 A ‘body of persons corporate or unincorporated’: Interpretation Act 1978 (UK) c 30, s 5, sch 1.
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

5.4 Periodic Disclosure Requirements in the Secondary Market

The aim of this section is to define periodic disclosures in the Saudi secondary market. After that, it will examine the current legal requirements for periodic disclosures under the Saudi securities regulations and in selected developed countries. Then, an evaluation of these requirements will be carried out in order to determine whether the disclosure regime is adequate or not in respect of periodic financial reports in Saudi Arabia.

5.4.1 Scope and Meaning of Periodic Disclosures

Companies listed on the stock market are required to disclose periodical financial statements/reports. Periodic disclosures are contained in quarterly, half-yearly and annual reports. The purpose of these reports is to keep investors informed about the company’s financial status and their investments in these companies’ securities. In fact, disclosure of material information through periodic reports to groups of people or other interested parties before such information is released to the public may undermine investor confidence in the integrity of the securities market. Principle H of the Principles for Periodic Disclosure of the International Organisation of Securities Commissions Organisations (IOSCO) asserts that equal access to disclosure should be provided to all investors at the same time.

With this in mind, compliance with certain requirements must be imposed on listed companies. Misstatement in, or omission from, a periodic disclosure document, that is, a failure to meet the legislative or regulatory requirements, leads to defective periodic

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586 See Capital Market Law 2003 (Saudi Arabia) art 45; Listing Rules 2004 (Saudi Arabia) arts 26, 27. In this thesis, the terms ‘statement’ and ‘report’ are used frequently to describe the form of information that the company produces to the public.

disclosures. As a result, investors may be affected by non-compliance with the legal requirements and, therefore, sustain loss or damage.

5.4.2 Periodic Disclosure Requirements under Securities Laws in Selected Developed Countries

Periodic disclosure requirements are investigated in the light of the legislation and associated regulations in the US, the UK, Australia and Canada. The purpose is to come to a decision about whether the Saudi securities market has a sufficiently robust periodic disclosure regime.

In the US, § 13 of the SEA’34 provides the requirements for periodic reports. Additional requirements for periodic financial disclosures were inserted in § 401 of the SOX’02, which deals with disclosure in periodic reports. Issuers with publicly traded shares are obliged, on an ongoing basis, to make periodic disclosures on Forms 10-K, 10-Q, and 8-K, as required by the Securities Exchange Commission (SEC).

In the UK, Rules 4.1.12 and 4.2.10 of the DTR’06 provide obligations for periodic disclosure. It is a regulatory responsibility imposed on the persons making statements and compiling the annual and half-yearly reports. In Australia, Part 2M of the CA’01 provides obligations with which entities must comply in terms of financial and audit reporting. In addition, Rule 4 of the ASX Listing Rules sets out the requirements that

588 Forms 10-K, 10-Q, and 8-K shall be used pursuant to § 13 or 15(d) of the Securities Exchange Act 1934 (US) and are required by the Securities Exchange Commission (SEC). Form 10-K is an annual report; Form 10-Q shall be used for quarterly reports; and Form 8-K is a document used to announce certain significant changes in a public company, such as a merger or acquisition. Securities and Exchange Commission, Annual Report Pursuant to Section 13 or 15(d) (11 April 2012) <http://www.sec.gov/about/forms/form10-k.pdf>.


591 Australia uses a co-regulatory model for company reporting and disclosure, with the Australian Securities Exchange (ASX) and Australian Securities and Investment Commission (ASIC) as joint regulators. This partnership is underpinned by a memorandum of understanding. See Australian Securities and Investments Commission, Memorandum of Understanding Between Australian Securities and
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

a listed company will have to satisfy in relation to each quarter, half yearly and end of the year report.592

In Canada, the National Instrument 51-102 Continuous Disclosure Obligations 2002 provides periodic disclosure requirements.593 It recognises different types of disclosure, particularly for annual and interim financial statements.

The legal requirements for periodic disclosures in Saudi Arabia will be investigated in the light of the above developed jurisdictions. An examination of equivalent requirements will be carried out in the subsequent discussion of Saudi laws.

5.4.3 Periodic Disclosure Requirements under Securities Laws in Saudi Arabia

Saudi laws impose certain requirements for periodic disclosure. Article 45 of the CML’03 states that issuers with securities traded on the SSE must submit quarterly and annual reports to the CMA.594 Hence, SSE listed companies are required to submit quarterly financial statements within two weeks from the end of each quarter. Annual financial statements that have been reviewed by auditors are to be submitted within 40 days of the end of the financial year. In general, art 45(a) of the CML’03 requires all periodic reports to contain the following:

i. The balance sheet

ii. The profit and loss account

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594 Capital Market Law 2003 (Saudi Arabia) art 45(a); According to this article, it is understood that periodic disclosures in Saudi Arabia are quarterly and annual reports.

183
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

iii. The cash flow statement

iv. Any other information as required by the rules of the Authority.

In addition to the information required in paragraph (a) of art 45, paragraph (b) provides that the annual report must contain the following:

i. An adequate description of the company, the nature of its business and its activities.

ii. Information regarding the directors, executive officers, senior staff and major investors or shareholders.

iii. An evaluation of the company management of current and future developments.

iv. Any other information as may be required by the CMA.595

The CMA requires annual reports to be audited in accordance with the accounting standards issued by Saudi Organisation for Certified Public Accountants (SOCPA).596 The CMA prohibits listed companies from disclosing any report’s information before it has been properly lodged and disclosed to the public.597 In addition, the disclosure of annual reports has additional requirements, which can be found in art 26 of the LR’04.598 A listed company must provide the interim and annual accounts of a listed company and must be approved by the board of directors and signed by a director

595 Ibid art 45(b).
596 SOCPA is a professional organisation established under Royal Decree No. M12 dated 1 Jumada al-Ula 1412H (19 November 1991G). It operates under the supervision of the Ministry of Commerce in order to promote the accounting and auditing profession and all matters that might lead to the development of the profession and upgrading its status.
597 See Capital Market Law 2003 (Saudi Arabia) art 45(c): ‘All information and data described in paragraphs (a – l, 2, 3) and (b.3) of this Article shall be deemed confidential. Before providing and disclosing such information and data to the Authority, the issuing company shall be prohibited from disclosing such information to parties not bound by a confidentiality obligation and an obligation to protect such information.’
authorised by the board of directors and by the CEO\textsuperscript{599} and the CFO\textsuperscript{600} prior to their issuance and circulation to shareholders and third parties. Immediately, the interim and annual accounts and the director’s report must be filed with the CMA. The issuer must provide to the CMA and announce to the shareholders its interim accounts (which must be prepared and reviewed in accordance with the accounting standards issued by SOCPA) within a period not exceeding 15 days after the end of the financial period to which they relate. Then, the issuer must provide to the CMA and announce to the shareholders its annual accounts as soon as they have been approved and within a period not exceeding 40 days after the end of the annual financial period to which they relate. The issuer must provide to the CMA and announce to the shareholders these annual accounts not less than 25 days before the date of the issuer’s annual general meeting.

Furthermore, the LR’04 requires the issuer to include the company board report with the annual report. The board of directors’ report must contain a review of the operations of the issuer during the last financial year and of all relevant factors affecting the issuer’s business, which an investor requires to assess the assets, liabilities and financial position of the issuer.

Another obligation stated in the MCR’04 is to:

\textsuperscript{599} According to \textit{Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority 2004} (Saudi Arabia), the CEO refers to ‘the chief executive officer, being any individual who heads the operations of any person and includes the managing director, the chief executive, the president of the company or equivalent’. Another definition of the CEO is ‘chief executive officer, a director appointed by the board of directors of a company’. The position is also known as ‘managing director’. See Nygh and Butt, above n 105, 90 and 310.

\textsuperscript{600} ‘CFO’ refers to any person who manages the financial affairs of another person, whether under the name of chief financial officer or finance manager or equivalent. See \textit{Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority 2004} (Saudi Arabia).
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

prohibit any persons from giving oral or written statements in relation to material facts … with the purpose to affect the security price or to induce another person to purchase or sell a security, or to refrain investor from trading in securities.601

Another disclosure obligation is mentioned in arts 8 and 9 of the Corporate Governance Regulations 2006 (CGR’06). They emphasise the policies and procedures related to disclosures, especially disclosures in the board of directors’ reports.602

Indeed, it can be said that Saudi Arabia has adopted the same approaches that require companies to disclose their financial reports for each quarter and annually. In addition, examination reveals that the CMA has the regulatory and supervisory role in regard to periodic disclosure that is in line with the approach that taken by developed countries. The Saudi periodic disclosure regulation applying to listed companies includes the statutory reporting requirements, the CMA periodic disclosure, LR’04 and CGR’06.

A major development has been that the CMA has recently become a member of the International Organisation of Securities Commission (IOSCO), which requires more efficient and transparent disclosures in the secondary market.603 Moreover, similarly to those of selected developed countries, Saudi securities regulations have recognised the periodic disclosure requirements and given the regulatory role to one body — in this instance the CMA — to govern, supervise and enhance periodic disclosure requirements.

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602 Corporate Governance Regulations 2006 (Saudi Arabia) arts 8, 9.
603 In fulfilling the criteria for membership, the applicants demonstrated their commitment to IOSCO’s Objectives and Principles of Securities Regulation and that their regulatory regimes allowed them to become signatories to Appendix A of the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information. For details, see ‘IOSCO Expands its Global Membership’, above n 22.
Despite all listed companies having to submit quarterly and annual reports to the CMA, only annual reports must be audited as required by the CML’03. In contrast, the ASX Listing Rules require the quarterly, half-yearly and yearly reports to be audited and given to the ASX prior to publication. In the UK, in addition to requiring an audited annual report, Rule 4.2.9 of the DTR’06 declares that the half-yearly financial reports must also be audited. Auditing all periodic financial reports which are to be disclosed to the public is necessary to ensure the adequacy of the information contained in those periodic reports. As a result, the Saudi securities regulator needs to insert a legal requirement that requires listed companies to audit their quarterly financial report before it is disclosed to the public. This will strengthen the fairness of the market and thus increase the investor protection.

Another issue is that the compliance with periodic disclosure requirements by listed companies in Saudi Arabia is yet to be improved. A recent report released by IOSCO provides nine principles for periodic disclosures by listed entities. The intention of the report is to provide securities regulators with a framework for establishing or reviewing the periodic disclosure regime for listed companies. For instance, the ‘disclosure criteria’ principle (Principle G) states:

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604 Capital Market Law 2003 (Saudi Arabia) art 45(a); Listing Rules 2004 (Saudi Arabia) annex 6.
605 The Report identifies the following principles:
Periodic reports should contain relevant information:
1) Periodic reports in which financial statements are included should state that the financial information provided in the report is fairly presented.
2) The issuer’s internal control over financial reporting should be assessed or reviewed.
3) Information should be available to the public on a timely basis.
4) Periodic reports should be filed with the relevant regulator.
5) The information should be stored to facilitate public access to the information.
6) Disclosure criteria.
7) Equal access to disclosure.
8) Equivalence of disclosure.
For details, see the Technical Committee of IOSCO, ‘Principles for Periodic Disclosure by Listed Entities’ above n 587, 7.
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

The information disclosed in periodic reports should be fairly presented, not be misleading or deceptive and should not contain any material omission of information. Moreover, information disclosed in a periodic report should be presented in a clear and concise manner without reliance on boilerplate [standardised format] language.  

It can be said that the application of this principle to the Saudi securities market is inadequate. Compliance with the current periodic disclosure regime remains unsatisfactory by the companies listed on the SSE. Thus, according to market observers, there are widespread calls for full and fair disclosure of periodic financial reports by listed companies. The current lack of compliance with the disclosure requirements, especially in periodic financial reports, can badly affect the quality of advice given by financial analysts, who rely on information contained in the periodic reports to issue their analyses and advice to potential and current investors. It shows the possibility of an unnecessarily high risk in regard to investment decisions and investments in the market that are made in accordance with those financial reports that may inadequately reflect the financial condition and position of the company. Such risk is inversely proportionate to the quality of the documents: the higher the quality, the lower the risk of poor decision making. Reliability of reporting also increases the overall degree of investor confidence. Hence, ensuring the quality of such reports is highly important.

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606 Ibid 24.
607 Mohammed Alanqeri, 'Disclosure and Transparency in the Balance', alphabeta (online), 11 January 2011 <http://alphabeta.argaaem.com/?p=25374> [Arabic]. One of the purposes of disclosure is to fairly present the company’s financial condition and results of operation, and for such disclosures to be made on a timely basis as required by applicable laws. For details, see Kenneth Wiener, 'Civil Liability for Secondary Market Disclosure and CEO/CFO Certification of Annual and Interim Filings' (Report Presented at CCCA Annual Meeting, August 2003) <http://www.goodmans.ca/docs/CCCA_Civil_Liability.pdf> 44.
608 Alzahrani and Skerratt, above n 39.
609 In this context, the meaning of ‘quality’ of financial reports is to have full disclosure of all information required by the law and the securities commission rules, to reflect the true financial situation of the listed company and therefore allow investors to make an informed investment decision.
The above evidence demonstrates the role that the CMA needs to take in order to foster investor confidence as well as to maintain investor protection from misleading periodical financial statements. As a result of this examination, it can be seen that although the CMA is a member of IOSCO, it does not completely satisfy that organisation’s principles. Finally, periodic disclosure requirements in Saudi Arabia need to be frequently reviewed to provide full, fair and timely disclosure by listed companies. In an empirical study undertaken during the period from 2001 to 2005, Aljabr found that despite the fact that disclosure in terms of annual reports by listed companies has improved since the establishment of the CMA, a delay persists in presenting annual financial statements by struggling companies. Most recently, three listed companies breached the legal requirement to release their 2011 annual reports on time. These companies are financially struggling and have an unstable performance in the market. In practice, the delay in releasing annual financial reports combined with the ineffective role of the CMA in terms of a willingness to strengthen the legal requirements for the periodic disclosures will hinder investors from making knowledgeable investment decisions. Strengthening the civil liability regime for defective periodic disclosure will result in better compliance with the disclosure regime and improve transparency in the secondary market. The following section will

610 See also IOSCO Principles for Auditor Oversight which sets forth general principles for the oversight of audit firms and auditors that audit financial statements of companies whose securities are publicly traded in the capital markets; International Organisation of Securities Commissions, ‘Principles for Auditor Oversight, Statement of the Technical Committee of IOSCO ’ (Report, October 2002) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf> 3.


612 These companies are: Saudi Telecom Integrated Company, Allied Cooperative Insurance Group (ACIG), and Buruj for Cooperative Insurance. Khaled Algharbi, 'Halt Trading Threatens Three Companies', Aleqtisadiah (online), 30 March 2012 <http://www.aleqt.com/2012/03/30/article_641433.html?related> [Arabic].
demonstrate that the protection of investors is the key objective of civil liability for non-compliance with the legal requirements for secondary market disclosures.

5.5 The Objective of Civil Liability for Defective Disclosure in the Secondary Market

Objectives for civil liability are twofold: the deterrence of wrongdoers and compensation for investors who suffer loss or damage due to the wrongdoing. Thus, the twofold contribution to protect investors is the ultimate objective of imposing civil liability for defective disclosure in the secondary market. A recent study of civil liability for defective disclosure in the secondary market asserts that ‘the availability of a civil liability regime for secondary market disclosure enhances the public policy of investor protection, as it creates civil remedies for misrepresentations’.\(^{613}\) It allows investors, individually or through approved class actions, to hold the issuer and its directors, officers and any liable person accountable for their failure to meet statutory disclosure requirements. Halperin and Goldman state that:

Civil liability for secondary market disclosure means that investors will more easily be able to hold issuers and their individual representatives responsible for the accuracy and completeness of information provided in documents, such as financial statements and press releases that companies publish on an ongoing basis.\(^{614}\)

Shulman claims that the primary purpose of the imposition of civil liability provisions in securities is to create compliance with the law rather than compensating investors.\(^{615}\) He argues, however, that civil liabilities, in turn, have a dual purpose: compensation of

\(^{613}\) Sarra, above n 549, 76.


\(^{615}\) Shulman concludes his discussion by stating that, ‘Civil liability is imposed partly for the purpose of compensating investors, partly, and probably more, for the purpose of compelling compliance with the Act so as to avoid certain types of losses and the need of compensation’. For details, see Shulman, above n 274.
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

injured investors and prevention of conduct and transactions which would cause losses and create a need for compensation. Nevertheless, compliance with the regulations by market participants will ultimately serve the objective of investor protection. A study of the Canadian securities law found that the absence of statutory civil liability for continuous disclosure misrepresentations had (‘until very recently’) made the shareholder’s exercise of a right of private enforcement (via ‘common law torts of negligent or fraudulent misrepresentation’) difficult, as did legal costs based on ‘loser pays’ and a reluctance to pursue a class action.

Having efficient legal requirements coupled with an improved civil liability regime will foster investor confidence in the capital markets. For that reason, it is believed that the presence of secondary market liability increases market stability. La Porta, Lopez-de-Silanes, and Shleifer show that disclosure requirements and liability standards are more strongly associated with financial development than other legal factors. To this end, it is important to find out the civil liability provisions that deal with violations of the legal requirements for secondary market disclosure in Saudi Arabia. The next section will highlight the availability of civil liability provisions for defective disclosures in the secondary market under the Saudi securities laws and associated regulations.

5.6 Provisions Dealing with Civil Liability for Defective Disclosures in the Secondary Market under the Saudi Securities Laws

Article 56(a) of the CML’03 is a statutory provision which imposes civil liability enabling investors who sustain loss or damage due to violations of the secondary market disclosure requirements, including defective disclosures in the secondary market, to

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616 Ibid.
618 La Porta, Lopez-De-Silanes and Shleifer, above n 4, 27–8.
recover compensation. Paragraph (a) of art 56 of the CML’03 imposes civil liability for misstatements in periodic disclosures. This provision states that:

Any person who makes, or is responsible for another making, orally or in writing, an untrue statement of material fact or omits to state that material fact, if it causes another person to be misled in relation to the sale or the purchase of a Security, shall be liable for compensation of the damages.619

Additionally, art 10 of the MCR’04, which was issued for the purposes of the application of art 56(a) of the CML’03, provides civil liability for defective disclosures in secondary market. According to arts 10(a) and 10(c) of the MCR’04:

(a). A person shall be liable for damages to a claimant if he makes an untrue statement of material fact and the statement is made: 1) for the purpose of profit or commercial benefit; and 2) in relation to the purchase or sale of a security.620

(c). A person shall be liable for damages to a claimant, if he is obliged under the CML’03 and CMA regulations to make a statement and fails to do so provided that: 1) the claim for damages is in relation to the purchase or sale of a security; and 2) what has been omitted relates to a material fact.621

Although the above provisions are unclear as to whether they are applied to the secondary market or not, a decision was issued based on art 56(a) by the Committee for the Resolution of Securities Disputes (CRSD) to compensate a victim of untrue statements.622 However, the above provisions will be examined to find whether they are applicable to defective disclosures in the securities market. As it is shown above, the first provision is contained in paragraph (a) of art 56 of the CML’03. It requires that any person who is responsible for giving (orally or in writing) an untrue statement of material fact, or omits a necessary statement of material fact, must compensate investors who suffer loss or damage as a result of this act or omission. The second provision is

619 Capital Market Law 2003 (Saudi Arabia) art 56(a).
620 Market Conduct Regulations 2004 (Saudi Arabia) art 10(a).
621 Ibid art 10(c).
found in paragraphs (a) and (c) of art 10 of the MCR’04, which bring civil liability for
defective statements in accordance with art 56 of the CML’03. Materiality is defined in
art 56 exactly as it was in art 55 which deals with defective prospectus.623

The above provisions can be applied to non-compliance with the continuous and
periodic disclosure requirements of the SSE.624 Beach describes art 56 of the CML’03
as ‘the CML’03’s anti fraud provision’.625 Thus, it can be assumed art 56 can be applied
to any misstatement in both the primary and secondary securities markets.626 This is an
assumption made due to the serious dearth of case law and judicial interpretations in
Saudi Arabia which creates greater ambiguity regarding secondary market disclosure
liability.627 Moreover, it is said that this may be due to the ‘infant’ capital market law
which nevertheless has established a specialised court for securities market violations.

However, the following sections will examine the above civil liability provisions in
terms of their applicability to violations of the legal requirements for both continuous
and periodic disclosure in Saudi Arabia.

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623 Capital Market Law 2003 (Saudi Arabia) art 55(a) states that ‘[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’.
624 Ibid arts 45, 46. It is worthwhile to also mention that paras (a) and (c) of art 10 of the Market Conduct
Regulations 2004 (Saudi Arabia) are used for the purpose of the application of art 56 of the Capital
Market Law 2003 (Saudi Arabia).
625 Beach, above n 24, 348.
626 In fact, art 56 of the CML’03 is a direct translation of § 18(a) of the Securities Exchange Act 1934
(US). This provision could be applied to violations in both primary market and secondary market.
627 There is only one case law found imposing civil liability on a newspaper for an untrue statement which
caused loss for the investor. See CRSD Decision No 508/L/D1/2009 of 1430 H issued 14 April 2009.
5.7 Civil Liability Provisions and Their Applicability to the Defective Continuous Disclosure

5.7.1 Civil Liability for Continuous Disclosure in Saudi Arabia

Article 56(a) of the CML’03 and arts 10(a) and 10(c) of the MCR’04 provide civil liability for untrue statements of material fact. For the purpose of this liability, the untrue statement has to have an effect on the investor decision to buy or sell, which therefore affects the share price or value. This demonstrates the requirements of causation to impose the civil liability. Hence, the violation of the continuous disclosure should have an effect which leads to the loss or damage. Consequently, the above provisions require a liable person to compensate investors who are aggrieved as a result of untrue statements of material facts.

In respect of persons liable for defective continuous disclosure, art 56(a) of the CML’03 and arts 10(a) and 10(c) of the same Act declare that, ‘any person’, whether a natural or legal person, can become a subject of civil liability for defective continuous disclosures. These requirements are similar to those of paragraph (a) of art 10 of the MCR’04, which imposes civil liability on ‘a person’ who makes untrue statements of material fact. These civil liability provisions do not specify who can be held liable for making defective ongoing disclosures that cause loss or damage for investors. The dearth of legal suits and resultant lack of judicial interpretation have also contributed to the absence of explicit specification of liable persons.

628 For the purpose of this Article, a statement or omission shall be considered related to an important material fact in accordance with the standard provided for in para (a) of Article 55 of this law, ‘to the Committee that had the investor been aware of the truth when making such purchase it would have affected the purchase price’.

629 The term ‘person’ is defined as any natural or legal person recognised as such under the laws of the Kingdom. See Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority 2004 (Saudi Arabia).
Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

It should be noted that the CRSD interpreted art 56(a) of the CML’03.\textsuperscript{630} The CRSD imposed an obligation on a newspaper to compensate an investor the loss he suffered because of the untrue statement regarding a listed company. The CRSD reasoned that:

[B]based on art 56(a) which states that any person will be held civilly liable if he/she makes untrue statement and the statement that was published has affected the share price, the newspaper is responsible to compensate the aggrieved investor the amount he lost because of the untrue statement.

This decision shows that art 56(a) was applied to a party other than the issuer in respect of the untrue material information that affected the value of the security and induced investor to buy or sell. Nevertheless, there is need for a clear civil liability for the breach of the legal requirements for continuous disclosures.

It has been seen that the civil liability provisions can be applied to all breaches of primary and secondary market disclosure regimes.\textsuperscript{631} An examination of the applicability of these provisions to defective continuous disclosure is imperative to determine whether the Saudi securities regulations are efficient or not in respect of investor protection in the secondary market. Thus, in order to examine art 56 of the CML’03, and arts 10(a) and 10(c) of the MCR’04, the following section will attempt to track civil liability provisions for breaches of continuous disclosure requirements in the selected countries. Based on this, an evaluation of the current civil liability provisions for defective continuous disclosure in Saudi Arabia will be undertaken to determine the weaknesses and suggest improvements.

\textsuperscript{630} CRSD Decision No 508/L/D1/2009 of 1430 H issued 14 April 2009.
\textsuperscript{631} Capital Market Law 2003 (Saudi Arabia) art 56(a) and Market Conduct Regulations 2004 (Saudi Arabia) art 10 (a)(c) were the only provisions that can be applied to defective periodic disclosures.
5.7.2 Civil Liability for Defective Continuous Disclosure in Developed Countries

The liability for breaches of continuous disclosure provisions are investigated in the light of the statutes and judicial precedents of the US, the UK, Australia and Canada. All these countries have developed a civil liability regime for violations of continuous disclosure requirements.

In the US, Rule 10b-5 of the SEA’34 is the principal provision for claiming defective disclosures, which affects market trading once securities have been issued. In addition, § 18(a) of the SEA’34 also provides civil liability for defective statements made in connection with purchase or sale in a security.632

In Canada, a statutory regime for secondary market civil liability was introduced in 2005. It allows those involved in secondary market to sue reporting issuers — officers, directors, spokespersons, influential persons633 and others — for violation of specified continuous and timely disclosure requirements. These amendments can be found in s 138 of the SA’90. The aim of s 138 is to impose civil liability for misrepresentations in the secondary market. Liability is imposed on reporting issuers, officers, directors, spokespersons and others for violation of specified continuous disclosure requirements.634 Therefore, the section enables the secondary market purchasers to recover loss or damage sustained from misrepresentation in public documents and in public oral statements and for failure to make timely disclosure of material changes.

632 Securities Exchange Act 1934 (US) § 10b-5 will be discussed further in Chapter 6.
633 The term ‘influential person’ includes insiders, investment fund managers, promoters and control persons; See Securities Act 1990 (Ontario) s 138.1.
634 See Part XXIII.1, s 138 of the Securities Act 1990 (Ontario) which came into force on 31 December 2005. Ontario is the first jurisdiction in Canada to introduce a statutory regime for secondary market civil liability.
Australia has a developed continuous disclosure regime. Civil liability for defective continuous disclosure is available under the CA’01. A breach of s 674(2) can result in an order for compensation for damage or loss suffered by a person. Persons who suffer loss or damage as a result of a listed entity’s breach of s 674(2) may recover that amount from the entity under s 1317HA. Section 1325 of the CA’01 provides that an order may be made against a person engaging in the relevant contravention or against a person who is involved in the contravention. The effect of this is to potentially extend the civil liability consequences for a breach of the continuous disclosure provisions to individuals associated with the relevant conduct. This section expanded the liability to not only include the entity but also a person who is involved in a listed disclosing entity’s contravention, with such person able to be held civilly liable.

In the UK, s 90A of the FSMA’00 imposes civil liability for misstatements in all information published by, or the availability of which is announced by, the issuer by means of a recognised information service (RIS) or other means required or authorised to be used when an RIS is unavailable. Therefore, announcements subject to this liability can be made through documents, RIS and secondary sources. Section 90A specifies a number of persons who can be held civilly liable for breaches of mandatory ongoing disclosure. These persons are the company, directors and senior executives of the issuer, that is, those having responsibilities in relation to the information in question or its publication.

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635 See Corporations Act 2001 (Cth) s 674(2A). For example, about the implementation of this section, see: Kim Riley v Jubilee Mines NL (2006) WASC 199.
636 Senior Executives are the individuals who hold the highest of organisational management and have day to day responsibilities of managing a company or corporation. However, a definition of the senior executive of the issuer in the UK has not been found under the Financial Services and Markets Act 2000 (UK) and the Companies Act 2006 (UK).
In the above developed jurisdictions, investors who suffer loss or damage as a result of breaching continuous disclosure requirements are entitled to sue for compensation. The company, directors, senior executives, officers, spokespersons, influential persons and others are clearly liable for the breach of continuous disclosure requirements in the UK and Canada. In Australia, it is clear that a claim of civil liability can be made against the company or any person engaged or involved in violating the continuous disclosure regime. In the US, civil liability is imposed on any person, directly or indirectly, in connection with the purchase or sale of any securities.

5.7.3 The Imposition of Civil Liability Provisions for Defective Continuous Disclosure in Saudi Arabia

There is no doubt that the ‘infant’ Saudi Arabian securities law and regulations issued by the CMA have a positive impact on the investor protection and the market as a whole. Moreover, these laws and regulations provide rules and impose requirements for disclosure in the secondary market which must be complied with. However, a strong civil liability regime will foster deterrence and will facilitate compensation for investors who suffer loss or damage as a result of a breach of disclosure requirements. This section aims to evaluate the adequacy of civil liability provisions for violations in continuous disclosures. It can be said that the existing drawbacks related to civil liabilities for continuous disclosure undermine investor protection. This is due to the fact that the provisions concerning civil liability for continuous disclosure are not sufficient. There are several reasons for this statement. The following discussions reveal why art 56 of the CML’03 and art 10 of the MCR’04 are insufficient. In addition, the preceding description of the civil liability provisions of different developed jurisdictions can contribute to identifying the shortcomings of the Saudi continuous disclosure civil
liability regime. Then, recommendations and suggestions can be drawn in order to improve this regime.

In fact, confusion is apparent when reading the current civil liability provisions for untrue statements. There is a clear absence of information about which market is targeted by these provisions; that is, whether it is the primary or secondary market. According to the articulation of these provisions, they can apply to any untrue statements without mentioning which disclosure type these statements are. Moreover, confusion results from the articulation of these provisions, which is in fact, general. The absence of specific civil liability provisions that deal with every type of disclosure can be considered a drawback of civil liabilities for continuous disclosure. For instance, in Canada, Part XXIII.1 of the SA’90, titled ‘Civil Liability for Secondary Market Disclosure’, indicates that civil liability is recognised in the secondary market. In addition, s 138.2 of the part clearly states that a prospectus does not fall under the application of this part but it would fall under another part of the Act. This surely means that that the two are distinguished but liability issues are covered for each. Furthermore, civil liability for defective continuous disclosure is provided in the same part. Section 138.3(4) requires responsible issuers, who fail to make timely disclosure, to pay compensation to affected investors. This section shows that the Canadian securities law imposes civil liability for non-compliance with the requirements for continuous disclosure. Similarly, s 674 of the CA’01 has a clear indication of the civil liability for continuous disclosure violations in Australia. In the UK, s 90A of the FSMA’00 clearly deals with civil liability for ongoing disclosure in the secondary market. In the UK,

637 For example, see s 85 of the Securities Act 1996 (British Columbia) clearly recognises civil liability for defective continuous disclosures.
failure or breach of compliance with the continuous disclosure obligations will result in financial penalties being imposed by the FSA in relation to any such failure. As a result, it can be seen that Canadian, Australian and the UK jurisdictions have a clear indication of civil liability for instances of non-compliance with continuous disclosure that have caused loss or damage to investors.

By contrast, the Saudi civil liability provisions are unclear in regard to breaches of continuous disclosure. Civil liability, as stated in art 56, is ambiguous in terms of who can be sued by affected investors who become victims of these violations. This is coupled with the serious lack of case law and judicial interpretations in Saudi Arabia, which result in more ambiguity regarding violations of continuous disclosure provisions. As a result, it is more likely for wrongdoers to easily escape liability. This will certainly lead to undermining investor protection in regard to the requirements for ongoing disclosure and the secondary securities market at large. Finally, it can be said that the need for the creation of a clear, strong and comprehensive civil liability regime for continuous disclosure is imperative in Saudi Arabia.

5.7.3.1 Persons Who Can be Held Liable for Defective Continuous Disclosures under Saudi Law

Securities laws always state that a public company as well as its officers and directors is subject to liability every time a public company releases information containing material information, misstatement or omission by the company, its officers and directors.638 However, it is argued that the identification of those who can be held civilly liable for defective continuous disclosure can strengthen investor protection.

Hence, aggrieved investors can easily identify who is liable and, therefore, sue them. In addition, the identification of those civilly liable will create deterrence for potential wrongdoers. For example, the UK jurisdiction clearly specifies the issuer, directors, and senior executives, as civilly liable. Canada extends the scope of the civil liability to include spokespersons and influential persons under the ambit of civil liability for defective continuous disclosures. Australia and Canada both have a clear civil liability imposition on the issuer and any other person who contravenes the continuous disclosure obligations.

On the other hand, in Saudi Arabia, in fact, there is no clear provision specifying who can be held liable for defective continuous disclosures. The only provision that can be considered to deal with liable persons is art 56(a) of the CML’03. However, the elements of this provision resembles its US counterpart of § 18(a) of the SEA’34

The article does indicate the following:

- the involvement of ‘any person’ that can be held liable for defective continuous disclosure by saying that ‘any person who makes, or is responsible for another making’ a defective disclosure;
- causation between the wrongdoing and the loss or damage is required;
- and it [the loss] has to be in relation to the sale or the purchase of a security.

However, contrary to art 56(a), the US provision adds that the degree of involvement includes direct and indirect involvement.

Although the Article provides civil liability for untrue statements, it does not specify who can be held liable. The term ‘any person’ in art 56 of the CML’03 is broad and it

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639 Financial Services and Markets Act 2000 (UK) c 8, s 90A.
640 Ibid c 8, s 90A; Corporations Act 2001 (Cth) ss 674(2) and s 1317HA.
remains unclear in terms of who will fall under the ambit of the civil liability. It can be considered an obstacle for investors who want to sue the liable person for the breach that caused him or her to suffer loss or damage. Moreover, the absence of specifying liable persons in art 56 can facilitate wrongdoers’ avoidance of responsibility. It weakens the deterrence for which civil liability is established. Consequently, it can be clearly said that provisions for persons liable for defective continuous disclosure in Saudi Arabia is insufficient. The discussion above shows that art 56(a) of the CML’03 is contrary to the objectives of investor protection. It can create uncertainty amongst affected investors in relation to whom they can sue for loss or damage for non-compliance with continuing disclosure obligations.

Consequently, it can be said that due to the ambiguity of civil liability provisions concerning continuing disclosure violations, there can also be ambiguity in determining who can be held liable. In addition, the lack of judicial interpretation of the CML’03 provisions makes the issue more difficult. Furthermore, it is believed that the liability of participants in continuous disclosure is yet to be determined under these provisions.

The term ‘every person’ broadens the scope of the liability to be imposed on every person who has caused loss or damage to investors, but it remains, nevertheless, ambiguous. It is suggested that there is a need to clearly specify persons liable for continuous disclosure contraventions. This is due to the fact that clear and specific civil liability provisions concerning liable persons will most likely create deterrence as well as protect investors by introducing a welcome degree of certainty in matters of civil liability in this area. The next section will discuss the question of whether or not Saudi Arabia has a civil liability regime for violation of requirements for periodic financial disclosures.
5.8 Civil Liability Provisions and Their Applicability to Defective Periodic Disclosures

5.8.1 Civil Liability Provisions for a Breach of Periodic Disclosure Requirements in Saudi Arabia

Civil liability for defective periodic disclosures can be claimed under the paragraph (a) of art 56 of the CML’03 which provides civil liability for a misstatement in, or omission from, documents issued that are subject to disclosure requirements regarding material information. In addition, paragraphs (a) and (c) of art 10 of the MCR’04 are civil liability provisions for defective disclosures in relation to sale or purchase of securities. These civil liability provisions are the same provisions which apply to breaches of continuous disclosures. Hence, civil liability can be claimed if the untrue statement causes another person to be misled in relation to the sale or the purchase of a security.\(^{641}\)

Hence, liable persons are required to compensate the investors who sustained loss or damage because of the untrue statement. Only listed companies in the SSE are usually identified as being able to be held liable for defective periodic disclosures. However, it can be said that there is a clear absence of a direct provision to practically indicate the civil liability for breaching periodic disclosure requirements. Hence, it is reasonable to claim that civil liability provisions for defective periodic disclosures are yet to be determined.

It has been mentioned that paragraph (a) of art 56 of the CML’03 imposes civil liability on ‘any person’\(^{642}\) who is responsible for defective oral or written statements. As a result, it can be said that persons involved in stating false information containing untrue,  

\(^{641}\) Market Conduct Regulations 2004 (Saudi Arabia) art (10)(a)(c). see also Capital Market Law 2003 (Saudi Arabia) art 56(a).

\(^{642}\) The term ‘person’ is defined as any natural or legal person recognised as such under the laws of the Kingdom; See Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority 2004 (Saudi Arabia).
misleading information or material omission, fall within the expression ‘any person’ and therefore are liable for making those untrue statements. Applying the same approach, paragraphs (a) and (c) of the MCR’04 use the term ‘a person’ to refer to anyone who can be held liable for making untrue statements that causes loss or damage to another person. Unfortunately, these liability provisions for making untrue statements have not been interpreted by the courts in Saudi Arabia. However, there is a need to identify all persons who are responsible for the preparation and authorisation of quarterly and annual financial statements.\textsuperscript{643} Specifying persons who can be held liable will provide certainty and therefore foster investor protection. It will create more deterrence, and assist aggrieved investors to become informed about whom they can sue for their loss or damage incurred as a direct result of violations in periodic disclosures by listed companies.

5.8.2 Civil Liability for Defective Periodic Disclosures under the Legislation of Developed Countries

Providing civil liabilities and specifying persons liable for defective periodic disclosures in securities markets will be investigated in light of the statutes and judicial precedents of the United States, the United Kingdom, Australia and Canada.

In the United States, civil liability for defective periodic disclosures is provided in § 18(a) of the SEA’34. The section imposes civil liability on any person who makes or causes statements in any application, report, or document to be false or misleading. As a result, persons become liable for damages caused by such reliance. A material

\textsuperscript{643} In this discussion and according to art 56 of the \textit{Capital Market Law 2003}, the term ‘untrue statement’ refers to oral or written untrue statements.
misstatement of the periodic filings is subject to liability under § 18(a) of the SEA’34.644

In the UK, the liability is found in s 90A of FSMA 2000, which deals with untrue or misleading statements in or omissions from periodic financial reports.645 It states that issuers are liable to pay damages to investors who suffered a loss as a result of:

- Any untrue or misleading statements in the relevant published information;
- Omission of any matter required to be included therein.

The issuer can be held liable by a person who acquires, continues to hold or sells securities, and in doing so, suffers loss in respect of those securities as a result of a dishonest delay by the issuer in publishing the relevant information.646 Directors and other persons beyond the issuer are not subject to civil liability by third parties; however, this exclusion does not take away the liability in criminal law or for civil penalties.647

In Canada, s 138.3 of the SA’90 clearly provides civil liability in Ontario for defective disclosures in the secondary market in general. It states that any person or company that acquires or disposes of the issuer’s security, during the period between the time when

644 Securities Exchange Act 1934 (US) § 18(a) states that ‘any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder…’.
See also liability for misstatement at Commerce and Trade 2005 (US) 15 USC § 78r; Fox, ‘Civil Liability and Mandatory Disclosure’ above n 223, 242.
645 Section 90A of the Financial Services and Markets Act 2000 (UK) was extended in terms of the issuers’ liability for public statements. The (Liability of Issuers) Regulations 2010 came into force on 1 October 2010.
647 ‘Liability’ here means any civil remedy (not just damages) and includes liability in regards to the self-help remedies of rescission and repudiation. Paras 7(2) and (5) of the (Liability of Issuers) Regulations 2010, Financial Services and Markets Act 2000 (UK); See also, Paul Davies, 'Liability for Misstatements to the Market' (2010) 5 Capital Markets Law Journal 443, 449.
the document was released and the time when the misrepresentation contained in the document was publicly corrected, has a right of action for damages. The section identifies the following persons to be liable for damages: responsible issuer, directors, officers and experts. Also, according to this section, a person who knowingly has an influence on the issuer, directors and officer is also liable.

In Australia, s 344 of the CA’01 states that, ‘a director of a company, registered scheme or disclosing entity contravenes this section if they fail to take all reasonable steps to comply with, or to secure compliance with Parts 2M.2 of the Corporations Act 2001’.

For this purpose, ss 1041H and 1041I of the CA’01 combine to allow an injured investor to bring a civil action against the liable person or any person involved to recover losses or damages resulted from false or misleading statements.

The above provisions show that all selected developed countries impose civil liability for the breach of periodic disclosures. However, the UK has the most recent and sufficient civil liability provision for violating periodic disclosures. It allows the securities seller, buyer and holder who have suffered loss or damage because of periodic misstatements to directly sue the issuer. In addition, any action by the issuer against other potential liable person would be left to the common law. As a result, having a specified person liable favours investor protection. In this situation, aggrieved investors can easily identify the party from whom they can seek compensation.

648 In this section, the term ‘document’ includes periodic reports, which are required to be filed with the Ontario Commission; see Securities Act 1990 (Ontario) s 138.1.
649 A ‘responsible issuer’ is a reporting issuer; or other with a substantial connection to Ontario, any securities of which are publicly traded. Ibid.
650 ‘This section’ refers to a civil penalty provision provided in the Corporations Act 2001 (Cth) s 1317E.
5.8.3 The Imposition of the Civil Liabilities for Defective Periodic Disclosures in Saudi Arabia

The aforementioned description of the civil liability provisions of the US, the UK, Australia and Canada shows that these jurisdictions provide civil liability for defective periodic disclosures. On the contrary, Saudi securities laws do not have a clear and direct civil liability for periodic reports. This is because Saudi law sets separate requirements for the disclosure of periodic reports, while there is no distinction between the civil liability for defective periodic disclosures and continuous disclosures. Article 56(a) of the CML’03 imposes civil liability for all misstatements in, or omissions from disclosures requirements regarding material information. Unlike the laws of Saudi Arabia and Canada, those of the US, the UK and Australia distinguish between the civil liability for periodic and that for continuous disclosures. However, the laws of the above developed markets clearly and directly impose the civil liability for defective periodic disclosures.

Furthermore, specifying the liable persons varies between the laws of developed jurisdictions and the CML’03. In Saudi law, art 56 imposes civil liability on ‘any person’ who is responsible for defective disclosures. This Article resembles § 18(a) of the SEA’34. The use of § 18(a) in the US has not been popular which is reflected in the lack of lawsuits brought under that section.  

However, in *Heit v Weitzen*, it was held that § 18(a) can be used as a concurrent claim of civil liability for any purchase or sale made in reliance on false or misleading statements made in documents filed with the SEC. Occhipinti points out that ‘[t]he target of any reinterpretation of section 18(a) must be its two distinct, interrelated, requirements: (1) the false or misleading statement

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652 402 F2d 909 (2nd Cir, 1968) 916.
must be in a document filed with the SEC, and (2) the plaintiff must have actually relied on the statement. However, the SEC is rapidly shifting to a continuous disclosure regime by supplementing periodic disclosure with ‘current disclosure’.

By contrast, the Canadian law identifies the liable persons for defective periodic disclosures as the following: issuer, directors, officers, experts and any person who knowingly has an influence on the issuer, directors and officers. Moreover, in the UK, the new extension in the civil liability regime of issuers clearly names the issuer as the liable person for defective periodic disclosures. Accordingly, FSMA 2000 (Liability of Issuers) Regulations 2010 identify the issuer as the liable person and explain when the issuer becomes responsible for such liability.

Consequently, it can be said that CML’03 suffers from the absence of direct and clear civil liability provisions for defective periodic disclosures. In addition, it includes the expression ‘any person’ involved in creating defective periodic disclosures to impose liability on those who are not specifically named in the relevant sections. Considering all the four mentioned developed jurisdictions together in the context of Saudi Arabia, art 56 is insufficient in relation to civil liabilities for misstatement in or omission from periodic financial disclosures. Based on the above, it can be observed that there is a lack of articulation of civil liability for defective periodic disclosures, coupled with the absence of judicial interpretations of art 56(a) of the CML’03. The present researcher could not find a lawsuit from the aggrieved investors against persons liable for defective periodic financial reports in Saudi Arabia.

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Chapter 5: Civil Liability for Defective Disclosures in the Secondary Market

On the other hand, the CMA fines listed companies for breaching the disclosure requirements of annual financial reports.  

Article 59(b) of the CML’03 deals with monetary fines for any breach of Saudi securities laws. The fine varies ranges from SAR10,000 to SAR 100,000 (USD 2666–USD 26,666). In contrast, the US Securities and Exchange Commission (SEC) imposed a USD 1 million administrative penalty against Pipeline Trading Systems LLC for misleading investors and providing defective disclosure in connection with the sale of securities.

It is evident therefore that even the administrative penalties are insufficient to deter companies from violating the disclosures rule regarding periodical disclosures. Recently, a commentator pointed out that the amount of the monetary fine is not adequate to prevent violations of legal requirements in companies’ annual reports. It is believed that these violations could directly adversely affect investors; hence applicable deterrence should be stronger.

In fact, listed companies continue to violate the periodic disclosure regime. The weak enforcement by the CMA does not provide sufficient incentive for potential wrongdoers to comply with disclosures requirements. In different cases, the CMA imposed administrative penalties on several companies that failed to disclose their annual financial statements for 2007. These companies violated art 26(d) of the LR’04,

656 Chapter 9 will discuss the role of the CMA in enforcing the disclosure regime.
which requires the issuer to provide financial statements to the CMA as well as the public within a period not exceeding 40 days after the end of the annual financial period. However, the civil remedy is insufficient to deter companies from violating the disclosure rule regarding periodical disclosures.

These legal weaknesses result in weaker protection of investors. The present civil liability provisions are clearly unable to create sufficient protection for market participants in the periodic disclosure regime. Empirical research finds that the link between investor protection and the quality of reporting is highly significant. Moreover, countries with poorer investor protections have smaller and narrower capital markets.

5.9 Summary and Conclusions

A corporate disclosure regime has emerged in the developed markets to meet the needs of investor protection. Disclosure continues to be the key tool for regulation within the

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660 The CMA announces that the following companies:
- Emaar the Economic City.
- The Mediterranean & Gulf Insurance Company.
- Anaam International Holding Group Company.
- Malath Insurance Company.
- SANAD Insurance Company.
- Saudi Fransi Insurance Company.
- SABB Takaful Company.
- Ashargiyah Agriculture Company.

have failed to disclose their results for the year 2007, within the period specified in art 26(d) of the listing rules, which states: ‘The company must provide the Authority and announce to the shareholders its annual accounts (which must be prepared and audited in accordance with the accounting standards issued by SOCPA) as soon as they have been approved and within a period not exceeding 40 days after the end of the annual financial period to which they relate’. As such delay is considered as a violation to the Capital Market Law, it is decided by the CMA Board to impose a penalty of SAR 10,000 on each of these companies.’


662 Rafael La Porta et al, 'Legal Determinants of External Finance', above n 19, 1131.
developed securities markets.\textsuperscript{663} Following the path of developed markets, Saudi Arabia has adopted the civil liability regime but without appropriate amendments to the laws pertinent to secondary market disclosure. The foregoing discussion demonstrates that the civil liability provisions for defective continuous and periodic disclosures in Saudi Arabia are insufficient and unclear when compared to those of other selected countries, such as the US, and particularly the UK, Australia and Canada. This weakness has been measured in terms of the extent of the scope of civil liability.\textsuperscript{664} The analysis shows that the imposition of civil liabilities for defective periodic and continuous disclosure is unclear in the current securities liability provisions in Saudi Arabia. In comparison, the UK, Australia and Canada have developed a civil liability regime governing secondary market disclosure.

In Saudi Arabia, the scope of civil liability concerning whether there are defective periodic or continuous disclosures is ambiguous and unclear, and the current legislative provisions have failed to specify persons who can be held liable for breaches of such disclosures. The civil remedy is insufficient to deter companies from violating the disclosure rule regarding continuous and periodical disclosures.

However, the preceding discussion also shows that the Saudi securities regulatory body has adopted a positive approach, which is to distinguish between the periodic and continuous disclosure requirements in the secondary market. However, they must be different because of their nature. This trend is in line with the approach of the selected developed countries, which apply different requirements for both periodic and


\textsuperscript{664} The following chapters will discuss remedies available to investors and also discuss defences available to escape civil liability for the violation of the disclosure regime.
continuous disclosure. Nevertheless, unlike the selected developed countries, there is no distinction between the provisions of civil liabilities of periodic and continuing disclosures. Likewise, the ambit of civil liability for defective disclosures is currently expanded to include all untrue statements. Thus, it can be said that the scope of the civil liability for whether there are defective periodic or continuous disclosures, is unclear. Moreover, the current provisions have failed to specify persons who can be held liable for breaches of periodic or continuous disclosure provisions. Consequently, the current civil liability provisions concerning disclosures in the Saudi secondary market are not favourable for investor protection.

Furthermore, the significance of having sufficient civil liability provisions for secondary market disclosure violation is derived from the importance of the secondary market where the trading volume is larger than the trading volume in the primary market. In addition, stock market crashes that occurred a number of times in several countries revealed the necessity for investor protection and have prompted greater attention in establishing a stronger regime.\textsuperscript{665} Therefore, investor protection is really needed in the securities market. Strengthening of the secondary market civil liability regime against defective periodic and continuous disclosures will certainly foster the protection of investors. Therefore, regulators are required to continuously improve and develop market regulations.

In addition, several negative issues persist that affect the quality of secondary market disclosure in Saudi Arabia. For instance, the practice of continuous disclosures by listed

\textsuperscript{665} Some historic tragedies in securities market were, for example, in England in 1720, in the US in 1929 and in Saudi Arabia in 2006. Except for Saudi Arabia, these market collapses significantly contributed to legislation favouring investor protection.
companies is still believed to be insufficient.\textsuperscript{666} Equally important, there is an enormous need for full and fair disclosure in periodic financial reports by listed companies.\textsuperscript{667}

A developed and clear civil liability regime for defective disclosure is imperative in order to foster investor protection in the securities market in Saudi Arabia. This regime needs to outline several main aspects, such as: ‘Who will be entitled to a right of action?’ ‘Who can be held liable?’ ‘What defences will be available?’ ‘What remedies are available?’ ‘How will damages be calculated?’ and ‘What are some of the procedural rules?’

With this in mind, the following chapter will continue the attempt to broadly discuss the current civil liability regime for defective disclosures. The adequacy of defences and remedies for the civil liability incurred from defective disclosures in the prospectus and continuous and periodic disclosures will be examined.

\textsuperscript{666} Responsibility for listed companies to develop ways to facilitate the disclosure of the important information, results and news of those companies in a more clear and understandable methods to the public. See Mohammed Alanqeri, ‘The Mystery of the Financial Market Weakness’, \textit{alphabeta} (online), 11 May 2011, Arabic <http://alphabeta.arqaam.com/?p=30181> [Arabic].

\textsuperscript{667} Alanqeri, ‘Disclosure and Transparency in the Balance’, above n 607. One of the purposes of disclosure is to fairly present the company’s financial condition and results of operations, with such disclosure to be made on a timely basis as required by the applicable legislation. For details, see Wiener, above n 607, 44.
CHAPTER 6: INVESTORS’ REMEDIES AGAINST THE BREACHES OF THE DISCLOSURE REGIME UNDER SAUDI SECURITIES LAWS

6.1 Introduction

An adequate civil liability regime is essential to provide protection for investors in the securities market. Remedies available to injured investors in the securities market are significant as a measure of the strength of a civil liability regime. Therefore, ‘good legal rules’ are of vital importance in all robust securities markets.668 Equally important, an adequate civil liability regime governing disclosure in the securities market is imperative. It has been asserted that civil liability provides significant incentives for entities to comply with the disclosure rules.669

This chapter will be evaluating the Saudi civil liability regime governing disclosure in the market — as to whether it is clear or ambiguous or narrow — as compared to that of the developed jurisdictions selected, namely the US, UK, Australia and Canada. Hence, the central focus of this chapter is to analyse the provisions dealing with civil liability in terms of investor remedies under the Capital Market Law of 2003 (CML’03). It is important to recognise the causes of action available to the aggrieved investors who sustain loss or damage as the result of a defective disclosure in either the prospectus or secondary market disclosures (periodic disclosures and continuous disclosures). The remedies available to investors will be discussed. The arguments regarding the relevant provisions providing remedies will be examined and evaluation of these provisions be conducted. This undertaking will reveal the inadequacy of the current civil liability regime for defective disclosures in Saudi Arabia.

669 Fox, ‘Civil Liability and Mandatory Disclosure’ above n 223, 273.
With this in mind, this chapter is divided into seven sections. Section 1 provides an introduction and section 2 presents the objective of the private enforcement of the civil liability provisions for the breaches of the disclosure regime. Section 3 introduces remedies in general and remedies available in the selected developed jurisdictions for the breach of disclosure requirements. Section 4 explores the investor remedies available for breaches of the disclosure regime in Saudi Arabia. Section 5 evaluates the weaknesses of the remedies available under the Saudi securities laws. Section 6 discusses the claim of civil liability and the absence of securities class action lawsuits as an effective remedy for the investors and strong deterrent to potential wrongdoers. Lastly, section 7 presents a summary and conclusions. The closing remarks will make it clear that the current civil liability regime is inadequate and to some extent contrary to investor protection, which is the central objective of the disclosure philosophy.

6. 2 The Objective of Private Enforcement of the Civil Liability for Breaches of Disclosure Regime

Effective civil remedies for investors encourage participants to comply with the securities laws, and also enhance disclosure of information to the market. The findings of La Porta, Lopez-De-Silanes and Shleifer are that private enforcement mechanisms (liability standards and disclosure requirements) are positively related to financial development while public enforcement measures are not.670 In fact, facilitating the right to bring civil lawsuits for investors is central for the development of securities markets.671 Such a right will foster fairness and integrity amongst all market participants. Veil points out that the implementation of a system of civil liability for violations of market rules has two goals: to ensure compensation for suffering investors,

670 La Porta, Lopez-De-Silanes and Shleifer, above n 4, 27.
671 Ibid.
and to ensure that firms and directors act with due diligence regarding compliance with regulations provided by the market administration.672

Private enforcement of securities laws (via shareholder lawsuits) is the cornerstone of the investor protection in the securities market. Having civil liability provisions for defective disclosure coupled with facilitating the use of these provisions can bring stronger protection for investors. In the early 20th century, Pound drew attention to the distinction between ‘law in books’ and ‘law in action’.673 The divergence between ‘law on the books’ and enforcement, ‘law in action’, is becoming an important factor in the discussion about investor protection in the financial markets worldwide. Coffee argues that measuring only the laws ‘on the books’ is misleading without finding out the strength of these laws ‘on the ground’.674

Enforcement of securities laws has strong advantages in regard to promoting transparency in the capital market and financial development.675 However, it is generally believed that public enforcement is less effective than private enforcement.

Part of the difficulty is that the impacts of imposing large monetary fines by the securities regulator on listed firms will extend to innocent investors rather than the culpable corporate officers and gatekeepers.676 In terms of actions by private individuals, the growth of the class action suit in the US and of contingency fee based actions allows persons to aggregate their claims and so redress the imbalance created by

676 Coffee, ‘The Law and the Market: The Impact of Enforcement’, above n 48, 304–6. Coffee asserts that the public enforcement should be used only when the corporation (and its shareholders) have received an improper benefit from the violation: at 305–6.
Chapter 6: Investors’ Remedies

the size of the corporations that might otherwise discourage a civil suit by an individual. Such approaches remain, however, largely peculiar to the US, although the approach is gaining some traction in Australia, the UK and even Europe.\(^\text{677}\)

The crash of the Saudi Stock Exchange (SSE) in 2006 — when it lost 65 per cent of its value in a few short months after a high in February of that year\(^\text{678}\) — raised questions about the role of the Capital Market Authority (CMA) in maintaining fair and efficient capital markets. Moreover, the right of aggrieved investors to recover their loss and damages was poorly expressed due to the insufficient civil liability provisions that govern the disclosure regime (as discussed in the previous chapters). In addition, several factors contributed to the weak private enforcement of the disclosure regime, namely: a lack of legal awareness among investors, a lack of trained and specialised lawyers in the securities literature and the weak judicial and administrative enforcement of securities laws in Saudi Arabia.\(^\text{679}\)

It has been submitted that the objective of the civil liability regime is to facilitate compensation for the victims of defective disclosure, and to deter persons involved in the preparation of prospectuses from infringing disclosure requirements. Consequently, to have an efficient civil liability regime for defective disclosure, an adequate private enforcement mechanism is required to be in operation rather than simply having laws ‘on the books’. For this purpose, it is important to analyse the remedies which can be utilised based on the civil liability provisions provided in the previous chapters. Having sufficient and adequate investor remedies for breaches of the disclosure regime will

\(^{677}\) Ibid 231, [n3] (US), 245 [n 33] (Australia and Canada), 266–74 esp 267 [nn 100 (Europe), 101 (UK)].
\(^{678}\) Al-Twaijry, ‘Saudi Stock Market Historical View and Crisis Effect’, above n 31, 1.
\(^{679}\) The later discussions on the judicial enforcement and administrative enforcement of securities laws will demonstrate these findings by the author of this thesis.
create strong incentives for market participants to comply with disclosure requirements and therefore lead to better investor protection.

6.3 Investor Remedies for Violations of the Disclosure Regime

6.3.1 Introduction to Remedies

In a legal sense, ‘remedy’ is ‘the means available at law or in equity by which a right is enforced or the infringement of a right is prevented, redressed or compensated’. Therefore, civil remedies can be divided into two categories. The first category is that of legal remedies, which are essentially a claim for monetary damages (that is, in compensation for the plaintiff’s loss, the defendant pays money). The second category of civil remedies is equitable remedies, which come as orders for the defendant to engage in a particular act, or refrain from engaging in a particular act. Wright observes that, ‘remedies are what clients want’. Moreover, it is very often said that every genuine case involves a remedy. In order to reach a conclusion regarding whether the current remedies for breaches of disclosure requirements in the Saudi laws are sufficient or not, the current regime for remedies is later discussed.

An efficient civil liability regime for defective disclosures requires adequate remedies to be available for investors who sustain loss or damage due to violation of the disclosure regime. It has been confirmed that securities regulations with adequate remedies

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680 Nygh and Butt, above n 105, 413.
682 Legal remedies are also defined as remedies at law, which are based on compensation to recover damages that have been proved by the victim.
684 David Wright, Remedies (Federation Press, 2010) 2.
685 Ibid 3.
available for investors will make a great contribution to the integrity of the securities market.\footnote{La Porta, Lopez-De-Silanes and Shleifer, above n 4, 27.} Hence, the variety of remedies available to aggrieved investors in the share market will facilitate the claim of civil liability and thus strengthen investor protection.

In addition, a study of 49 countries that were grouped into their relevant legal families — that is, English (common) law, French civil law, German civil law, and Scandinavian law — concluded that common law countries had more extensive mandatory disclosure requirements, and made it easier for investors to recover damages.\footnote{Ibid 17–28.}

That sufficient remedies being available to investors in the securities market is beneficial for the concept of investor protection has been observed by Ben-Ishai, who argues that ‘[u]nder common law, investors are able to bring an action against directors for a breach of fiduciary duty and duty of care, as well as seek remedies in contract and tort’.\footnote{Stephanie Ben-Ishai, 'Corporate Gatekeeper Liability in Canada' (2007) 42 Texas International Law Journal 441, 446.}

In contrast to the common law jurisdictions, which have civil remedies in legislation and common law, investors in the Saudi capital market only have recourse to the securities laws and regulations under which to seek civil remedies for breaches of the disclosure regime. This is essentially a disadvantage of the Saudi legal regime.

6.3.2 Overview of the Remedies Available under the Selected Developed Jurisdictions

The US, UK, Australia and Canada have remedies available in common law and under statutory laws as well. In these common law jurisdictions, there are both damages and equitable remedies available in a range of situations. Samuel classifies remedies by

\footnote{La Porta, Lopez-De-Silanes and Shleifer, above n 4, 27.}
\footnote{Ibid 17–28.}
\footnote{Stephanie Ben-Ishai, 'Corporate Gatekeeper Liability in Canada' (2007) 42 Texas International Law Journal 441, 446.}
Chapter 6: Investors’ Remedies

drawing a distinction between monetary and non-monetary remedies. He considers this distinction as a useful one for the contract and tort lawyer in that a claim for specific performance or injunction may bring into play different principles from those attaching to a claim for compensation. Rescission is a remedy that can be an equitable law remedy or one in common law, and is available in a number of situations. A civil law remedy of damages and/or the rescission of the ‘contract, disposition or other transaction procured by means of fraud’ may apply in a tort of deceit. The torts of negligence, negligent misstatement, of fraudulent misrepresentation, and torts of breach of fiduciary duty, and breach of contract all give rise to remedies. These remedies include: rescission, and, in particular, damages, as well as the two main equitable remedies for breach of contract, namely: specific performance and injunctions.

However, statutory remedies are available under the securities laws of the US, the UK, Australia and Canada. In the UK, Davies stressed that only those acquiring securities

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690 ‘Specific performance’ refers to equitable relief whereby an order directing the breaching party to perform the contract in the way specified by the court is issued. See Edmund Thomas Finnane, Christopher Wood and Nicholas Newton, Equity Practice and Precedents (Thomson Lawbook, 2008) 113.
691 ‘Injunction’ is a court order directing a party not to do something — eg, not to persist with a contractual breach. Typically, injunctions restrain the defendant from engaging in specified conduct. See ibid 43.
692 Samuel, above n 689.
693 Finnane, Wood and Newton, above n 690, 133. Rescission will be further discussed later in this chapter.
694 Ibid 133.
697 Ibid.
698 Legal and equitable remedies will be further discussed in the chapter of ‘Judicial Enforcement of the Securities Laws against Violations of the Disclosures Requirements’ (Chapter 9).
Chapter 6: Investors’ Remedies

could sue under the statutory regime\(^{699}\) and the ‘the statutory regime was the sole source of remedy for investors in the area in which it applied’.\(^{700}\)

In Australia, ss 737 and 738 of the *Corporations Act 2001* (Cth) (CA’01) provide investors with the right to withdraw and have money returned and refunded. In addition, ss 1041E and 1041F provide remedies for prospectus misstatement. In Canada, ss 130 and 138.3 of the *Securities Act 1990* (Ontario) (SA’90) provide the right of action for damages against breaches in prospectus and secondary market disclosure requirements. Also, investors in the secondary market have a limited right of action to seek compensation for damages resulting from a misrepresentation in a public disclosure or a failure to make disclosure of a material change.

In the US, § 11 of the *Securities Act 1933* (SA’33) provides the damages remedy to investors injured due to defective disclosure in a prospectus. Rule 10b-5 of the *Securities Exchange Act 1934* (SEA’34) is the principal provision relied on in suits claiming defective disclosures, which affects market trading once securities have been issued.

In the UK, s 90 of the *Financial Services and Markets Act 2000* (FSMA 2000) provides the remedy to investors who are aggrieved from misstatement in prospectuses. In addition, s 463 of the *Companies Act 2006* (UK) (CA’06) provides a remedy against directors of all companies. This remedy makes the director only liable in repaying an investor to compensate the company by the amount of loss suffered by the company.

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\(^{699}\) As ‘[s]ellers, holders and non- acquirers were excluded from the statutory remedies and their common law remedies, if any, were removed’: Davies, ‘Liability for Misstatements to the Market’, above n 647, 446, citing [n 11] ss 90A(3) and (6)(a) in the original version of that section.

\(^{700}\) Ibid.
Section 90A of the FSMA 2000 allows investors who had acquired securities to sue for breaches in the secondary market disclosures.

In fact, investors in the developed countries selected could seek civil remedies at the statutory level and at common law. Such remedies include: rescission, the right to withdraw and have money returned, and the right to return the securities and be reimbursed the amount paid for those securities. The variety of remedies creates stronger deterrence for potential wrongdoers and therefore greater compliance with disclosure requirements. Giving the aggrieved investor the right to claim in a civil action at common law for the loss or damages that resulted from the misstatement of disclosure requirements in the stock market facilitates the claim of civil liability. Moreover, the availability of judicial interpretations by the courts of the above developed countries has led to a better understanding of the civil remedies in both the statutory and common law. The following section will explore the civil remedies currently available for violations of the disclosure regime under the Saudi Securities laws.

6.4 Remedies Available under the Saudi Securities Laws

6.4.1 Causes of Action to Claim Civil Remedies for Defective Disclosures under Saudi Securities Laws

‘Cause of action’ is the legal ground or set of facts on the basis of which a party can file a lawsuit to obtain remedy.\(^{701}\) It is a corollary to the existence of a type of dispute where one party is entitled to some kind of legal remedy.\(^{702}\) Hence, before deciding to file any lawsuit, it must first be determined whether a party has a legitimate cause of action.

\(^{701}\) Nygh and Butt, above n 105, 84.
\(^{702}\) Peggy N Kerley, Joanne Banker Hames and Paul A Sukys, Civil Litigation (Delmar, 6th ed, 2011) 133.
Chapter 6: Investors’ Remedies

Also, the person who seeks remedy must have ‘locus standi’ which means the right to bring action.

To this end, in relation to civil liability, investors in the Saudi securities market have two causes of action under the CML’03. The first cause of action is that of the existence of defects in prospectuses according to art 55 of the CML’03. Defective disclosures in prospectuses constitute the legal ground for the private right to claim any damages or loss resulting from such defects. Another cause of action, according to art 56 of the CML’03, is the existence of defects in disclosure documents in connection with the purchase or sale of a security. These provisions entitle the investors aggrieved due to defective disclosures to sue for damages or compensation on these bases.

Such cause of action is defined as the ‘right of recovery’ in the event that an individual makes or is responsible for another making an untrue written or oral statement of material facts, or a material omission, in connection with another’s purchase or sale of a security (which results in loss or damage for that other person).

Based on the above, it can be said that investors in the Saudi securities market can claim civil remedy for their loss or damage resulting from defects in prospectuses and disclosure documents in the secondary market.

703 Capital Market Law 2003 (Saudi Arabia) art 55.
704 Ibid art 56.
705 In addition to these two causes of action, there are another two causes of action under the Capital Market Law 2003 (Saudi Arabia). The first cause of action is for those adversely affected by market manipulation. It can be found in art 49 of the CML’03, which deals with insider trading. The fourth cause of action is against unlicensed brokers. However, these causes of action are beyond the scope of this thesis.
6.4.2 Remedies for Breaches of Prospectus Requirements

In respect of prospectus disclosures, the only relief available to injured investors is to pursue damages suffered.\(^{706}\) The remedy is available to the injured party against every person who certified the content of the prospectus, every director and senior officer, every expert who certified part of the prospectus, and every underwriter.\(^{707}\)

The CMA’s approval of a prospectus is considered the triggering event for the cause of action in claiming remedy under civil liability.\(^{708}\) To claim civil liability, the omission or misstatement of a required material fact must exist at the time that the prospectus is approved by the CMA. The burden of proof is on the defendant and it can be expected that establishing proof in these matters is difficult.\(^{709}\) However, this will be discussed later in line with defences to civil liability.\(^{710}\)

This remedy allows the recovery of a specific amount of money. The basic rule is that the measure of damages is the difference between the price actually paid for the security value and the price at the time of claiming civil liability. It should be noted that this measurement of the damages is applied to the remedy of damages incurred by subscribing in prospectuses or in a secondary market investment.\(^{711}\)

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\(^{706}\) *Capital Market Law 2003* (Saudi Arabia) art 55(a).

\(^{707}\) Ibid art 55(e). See Chapter 4 the ‘Civil Liability for Defective Prospectuses’. Persons liable for defective prospectus is there discussed.

\(^{708}\) Beach, above n 24, 348.

\(^{709}\) For an example of the difficulties, such as the complexity of computing damages and the need for experts to calculate the damages, see Paul Grier, ‘A Methodology for the Calculation of Section 11 Damages’ (1999) 5 Stanford Journal of Law, Business and Finance 99, 100–1. Evidence in securities litigation will be further discussed in Chapter 7 ‘Evidence and Defences to Civil Liability for Defective Disclosures under Saudi Securities Laws’.

\(^{710}\) The evidence in securities litigation and causation will be further discussed in Chapter 7 ‘Evidence and Defences to Civil Liability for Defective Disclosures under Saudi Securities Laws’.

\(^{711}\) *Capital Market Law 2003* (Saudi Arabia) art 55(e) which deals provides civil liability for defective prospectuses states that ‘damages shall represent the difference between the price actually paid for purchasing the Security (not to exceed the price at which it was offered to the public) and the value thereof as of the date of
Chapter 6: Investors’ Remedies

However, it is not clear whether the damages remedy is available or not for a person who acquires shares in the secondary market following the issue of a defective prospectus. It is understood that under art 55(a) of the CML’03 the only persons able to seek a claim of damages for a prospectus breach are those subscribing under the prospectus. As this issue has not been addressed in Saudi securities literature, the CMA needs to make a clear policy position on the issue of liability in regards to the secondary market purchaser.

6.4.3 Remedies for Breaches of Disclosure Requirements in the Secondary Market

It has been seen that art 56(a) of the CML’03 provides the right to sue based on defects in any disclosure documents in connection with sale or purchase of a security. Hence, aggrieved investors may seek compensation for damages incurred. The articulation of art 56(a) is similar to that of § 18(a) of the SEA’34 which provides purchasers an express private right of action if they have been injured due to reliance on documents required to be filed under that Act. Although § 18(a) of the SEA’34 parallels § 11 of the SA’33, it is less effective because, unlike §§ 11 and 12, § 18(a) requires the buyer to 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, 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’.

Additionally, art 56(b) of the Capital Market Law 2003 (Saudi Arabia) provides:
‘The damages recoverable under this Article from any defendant, and the rights of indemnity and contribution among the persons responsible shall be as provided in paragraph (e) of art 55 of this Law.’

712 Section 18 of the Securities Exchange Act 1934 (US) (similar to art 56 of the CML’03) expressly creates a private remedy for false or misleading statements contained in any application, report or document filed with the SEC pursuant to the Securities Exchange Act in favour of any person, who in reliance upon such statement, purchased or sold a security at a price which was affected by such statement.
prove that s/he read the statement, and actually relied on the material misrepresentation.713

In regard to the secondary market, there is a need for straightforward provisions to provide the remedy of damages. This is necessary for improved investor protection in the secondary market. Legislative intervention in this issue could be better, by providing a clear damages remedy for breaches of disclosure requirements in the secondary market.

Based on art 56 of the CML’03, to claim this civil remedy for loss or damages resulting from an ‘untrue misstatement’, the plaintiff must, first, prove that at the time of purchase or sale s/he was unaware that the statement was defective; and, second, if in possession of such knowledge would not have proceeded with the transaction at the then prevailing price. The plaintiff must also demonstrate that the person responsible for the disclosure knew of its untruthfulness or that there was a ‘substantial likelihood that the information disclosed omitted or misstated a material fact’.714 The defendant has the burden of avoiding responsibility and proving that there was no causal link between the misstatement and the damage sustained by the plaintiff. The plaintiff is not required to show privity or prove causation between the misleading statement and the loss in situations where the price of the security is adversely affected.715 Thus the difference is that the plaintiff must show that the misstatement led to a decision to buy or sell as the price then offered while it is up to the defendant to show that there is no causal link between the misstatement and the damage sustained by the plaintiff.

713 Keller and Gehlmann, above n 366, 350.
714 Capital Market Law 2003 (Saudi Arabia) art 56(a).
715 Beach, above n 24, 348.
The remedy is available to the injured party against every person who makes, or is responsible for another making, orally or in writing, an untrue statement of material fact or omits to state that material fact. A recent judicial decision issued by the Committee for the Resolution of Securities Disputes (CRSD) is believed to be the only example of the enforcement of the private right in the secondary market. The cause of action was the untrue statement which was considered material and led the plaintiff to buy or sell the security in question. The measurement of the damages in secondary market disclosure breaches are the same as that in the prospectus.

6.5 The Drawbacks of Remedies Available under the Saudi Securities Laws

Investor remedies are inadequate under the Saudi securities laws and regulations. Based on the above description of the remedies available to investors who become victims of defective disclosures elsewhere, it can be said that the remedies available under the Saudi securities laws are inadequate. Whilst the remedy of damages is accessible by plaintiffs, it is, however, the only relief that an aggrieved investor can receive under the CML’03. This section aims to evaluate the drawbacks of the current civil remedies for breaches of the disclosure regime in Saudi Arabia. First, the remedy of damages in Saudi Arabia and developed countries will be discussed. Second, discussion will focus on the remedy of rescission as an important remedy to be available to investors in the Saudi capital market and its possible application in Saudi Arabia.

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716 Capital Market Law 2003 (Saudi Arabia) art 56(a).
718 Ibid.
719 Article 56(b) of the Capital Market Law 2003 (Saudi Arabia) provides: ‘The damages recoverable under this Article from any defendant, and the rights of indemnity and contribution among the persons responsible shall be as provided in paragraph (e) of art 55 of this Law.’
6.5.1 Weaknesses in Regard to the Remedy of Damages

In contrast to the above selected developed countries, in which jurisdictions it has been seen that investors are able to remedy their loss incurred from breaches of the disclosure regime in prospectuses and disclosure in the secondary market through the availability of a variety of legal avenues, and where damages is just one (though a major one) of the remedies available. In addition to the statutory remedies, aggrieved investors in the securities markets of the US, UK, Australia and Canada have remedies available in the common law. Hence, it can be argued that investors in these developed countries could be better protected than the investors of Saudi Arabia.

In spite of the strong similarities between the damages remedy under the securities laws of Saudi Arabia and the US, ambiguities persist in the current application of the remedy of damages arising from defective disclosures in the prospectus. For example, an examination of the application of the remedy of damages resulting from breaches of disclosure in prospectuses under the CML’03 reveals that the purchasers do not have to prove that they have relied on any misstatement in the prospectus (while in regard to ‘any defective documents in the market’, a plaintiff is required to show that there was an untrue statement or omission that was relied upon in the regard to a transaction). In comparison, § 11 of the SA’33 includes a single requirement in regard to this, and that is that reliance must be established where the issuer has generally distributed an earnings statement covering a period of at least 12 months following the effective date of the registration statement. Although the inclusion of such a requirement might

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721 Ibid art 56(a)(2).
722 Securities Act 1933 (US) § 11(a)(5) states that ‘the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission’. 
Chapter 6: Investors’ Remedies

appear to limit the use of this remedy, this requirement is missing under the damages remedy provision in the CML’03. Hence, the process of claiming civil liability may be easier for the investors in Saudi Arabia.

Another issue regarding the remedy of damages is whether the right to this remedy is available only to the subscribers or whether it extends to any holder of the security that is subject to misstatements or omission in the prospectus. For example, in the US, the right could be available to the holder of any of the securities issued under the registration statement, whether or not the plaintiff is the original subscriber or purchaser, or a subsequent purchaser.723 Lopez affirms that that the correct reading of § 11(a), coupled with the decision by the US Supreme Court, entitles secondary purchasers to seek damages through this right of action, which should not be just limited to transactions in public offerings.724 Giving this right to subsequent purchasers is consistent with the broadest possible protection for investors in the IPO and secondary markets.725 In Australia, there is nothing in s 729 of the CA’01 that limits the application of the remedy to persons that acquire securities under the relevant prospectus. In the same way, art 55(a) of the CML’03 has not mentioned any limitation to the application of the remedy. Certainly, with the absence of judicial interpretation by the Saudi courts, the availability of a clear position regarding this issue is important for secondary investors who are affected by defective prospectuses in the IPO market in Saudi Arabia.

However, it should be noted that there are disagreements regarding the extension of liability in regard to the secondary purchaser of the shares. For example, Curnin and Ford maintain that the accurate interpretation of the US legislation is that the ‘[o]nly purchasers in the actual initial distribution of securities itself have standing to maintain a claim under Section 11’. In the same way, the US Supreme Court held that § 12(2) only applies to initial purchasers of securities.

Despite the fact that the remedy of damages is found in art 56 of the CML’03, for the sake of investor protection there remains a need for a clear remedy for the victims in the secondary market. This is because of the value of investment in the secondary market, the number of investors and the massive effect of this investment on the economy at large. In this regard, it has been stated that the ‘private plaintiff plays a significant role in promoting optimum enforcement of mandatory continuous disclosure regime’.

However, there are strong similarities between art 56 of the CML’03 and § 12 of the SA’33 and §18(a) of the SEA’34 where there are anti-fraud provisions as the US regulator has improved the remedy of damages for secondary market disclosure violations. Section 18(a) of the SEA’34 provides the remedy of damages for investors who have sustained loss or damage as a result of breach of disclosure requirements associated with any type of disclosure document.

Rule 10b-5 in the US regime provides one of the most significant remedies for disclosure violations, even extending to secondary market trading. Lawsuits may

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728 Mayanja, above n 536, 66.
729 Securities Exchange Act 1934 (US) § 10(b).
Chapter 6: Investors’ Remedies

spring from defective material disclosure relied upon by investors, including in press releases, financial reports and even analyst reports posted on an issuer’s website.\(^{730}\)

Furthermore, civil damages under claims for defective prospectus and disclosure in the secondary market are identically measured. The basic rule is that the measure of damages is the difference between the price actually paid for the security and either the value at time of the claim, or any price for the securities prior to filing the claim with the CMA. Article 55(e) provides that the amount recoverable equals the difference between the amount paid for the security and any of the two following amounts:

1. The value of the security at the time the suit was brought.

2. The price at which the security was disposed of in the market before the suit was brought.

The above rules do not consider the changes in values of the security during the litigation. Section 11(e) of the SA’33 has the same rules that of art 55(e). However, § 11(e) not only has similar measurement rules but also has the rule that protects the plaintiff’s damages until the judgement. It provides the price at which the security was disposed of after the suit but before judgement, if those damages are less than the damages calculated on the basis of the first test above.\(^{731}\)

Despite the fact that a remedy of damages is available under the CML’03, the need for additional statutory remedies is significant for investor protection. It is important to develop the current civil liability regime in accordance with other developed securities

\(^{730}\) For example, the US Supreme Court case: *Janus Capital Group Inc v First Derivative Traders*, 564 US No 09-525 (2011)

\(^{731}\) Grier, above n 709, 103.
Jurisdictions. For instance, in Australia under the CA’01, remedies include: the right to withdraw and have money returned, and to return the securities and be refunded the amount paid for the securities. In the US, in addition to the right to seek damages, the plaintiff can obtain rescission, damages or equitable relief under § 12 of SA’33.

It can be argued that compared to some developed jurisdiction countries, the current civil liability in respect of investor remedies is insufficient to provide adequate investor protection in the Saudi Arabian securities market.

6.5.2 The Significance of Equitable Remedies as an Alternative to Damages

The second category of civil remedies is equitable remedies, which come as orders for the defendant to engage in a particular act, or refrain from engaging in a particular act. Wright observes that, ‘remedies are what clients want’. In the selected developed countries (the US, UK, Australia and Canada), investors’ civil remedies under common law could be greater than they would have been under their securities legislation. Hence, in circumstances where there is no adequate remedy at law, an injured party can seek the equitable remedies of rescission and restitution, specific performance, or reformation.

For instance, Schwartz argues that specific performance should be generally available as the remedy for breach. He suggests that specific performance does not present

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732 An example of a civil liability remedy (civil damages) in an Australian court and the ‘first example of civil damages for failure to disclose’ occurred some 12 years after the introduction of continuous disclosure in the jurisdiction: ‘On 6 September 2006, Master Sanderson in the Supreme Court of Western Australia awarded damages of $1.856 million to a private plaintiff for the negligent failure by Jubilee Mines NL to notify ASX of certain material information required under the old listing rule 3A. The action arose under the original s 1001A(2) as Jubilee Mines was negligent in not disclosing potential nickel deposits at its McFarlanes Find tenement in the period September to October 1994’: See Coffey, above n 562, 311.

733 David Wright, Remedies, above n 684.
substantial difficulties for the parties in the context of contracts. In the same way, Shavell concludes that if there is a substantial chance of underestimating the value of damages, specific performance should be employed because, by definition, it guarantees that the victim of a breach is ‘made whole’. An injunction is another equitable remedy, which is sometimes available as an alternative to an award of monetary damages as a means of enforcing a contract.

The discussion in this chapter and the followings chapters will illustrate the observation that investors in the Saudi capital market have essentially a single remedy which is compensation because equitable remedies are not accessible and therefore investor protection is weaker than that of developed countries. Even though the remedy of damages is available for injured investors, weak judicial and administrative enforcement make the issue difficult as will be demonstrated in a later stage of this thesis. However, the following discussion will highlight the importance of the remedy of rescission and its possible application in Saudi Arabia.

6.5.3 The Absence of the Remedy of Rescission

Rescission is a remedy available at common law and in equity. It allows the innocent party to cancel the contract by rescinding or annulled it. Under common law, there are several remedies for misrepresentation, with such remedies including rescission, damages for fraudulent misrepresentation and damages for negligent misstatement.

735 Ibid.
737 See further dissections of the legal remedies and equitable remedies in Chapter 8.
738 The civil liability remedies for misrepresentation in prospectus under the common law are detailed as follows:
   1. Rescission: generally rescission is available only if the issue is a new issue. As usual, the right to rescission is lost if the contract is affirmed (e.g. if dividends are received) or if restitution is not possible.
Where the remedy of rescission is available, the court will order rescission of the contract to subscribe for the shares and order restitution of the money paid under the contract. Traditionally, the test of liability for prospectus misstatement has been based on a ‘false or misleading’ statement or omission.\textsuperscript{739} The contract law remedy of rescission requires proof of a ‘false’ statement. The rescission remedy for misrepresentation in the prospectus is important to protect the purchaser of a new issue from any misrepresentation in the prospectus. Hence, if a person is induced to enter into a contract by false statements of fact made by the issuer, then there is a misrepresentation, and the innocent party is entitled to rescind the contract.\textsuperscript{740} Amongst developed countries, the US and the UK (for example), remedies of rescission and damages are available. Under the SA’33, reliance is not required for rescission because of the limitations of the remedy. However, in the US and the UK, the standard rules of the law of contract apply to violations in the prospectus, which allows the defendants to recover damages from the issuer for breach of contract. The civil remedy of rescission is available under the SA’33. For example, in \textit{Gustafson v Alloyd Co}, the Supreme Court of the US held that ‘under § 12(2) of the Securities Act of 1933 buyers have an express cause of action for rescission against sellers who make material misstatements or omissions “by means of a prospectus”’.\textsuperscript{741} The purchaser can obtain damages if the

\begin{itemize}
\item[2.] Damages for fraudulent misrepresentation: damages are limited to the amount needed to right the wrong done (i.e. the plaintiff cannot get damages for expected gains).
\item[3.] Damages for negligent misstatement: liability in tort may arise from a misrepresentation that is carelessly made. There must be a duty of care owed and the maker of the statement must have foreseen that the other party would rely on the statement. For more details, see Lorraine Griffiths and Susan Woodward, \textit{Corporations Law Workbook} (LBC Information Services, 3\textsuperscript{rd} ed, 1996) 367.
\end{itemize}

\textsuperscript{739} \textit{Corporations Act 2001} (Cth) s 728 changes the standard to one based on ‘misleading or deceptive’ statements. The historical case law clearly suggests that if a statement is untrue at the time it is made it will be false for purposes of determining falsity. See the statement in \textit{Flavel v Giorgio} (1990) 2 ACSR 568.

\textsuperscript{740} Len Sealy and Sarah Worthington, \textit{Cases and Materials in Company Law} (Oxford University Press, 8\textsuperscript{th} ed, 2008) 378.

securities have been disposed of. Moreover, in the US and the UK, in a prospectus there is a general duty of full disclosure and an express duty of due diligence; and express remedies of rescission and damages.

In contrast, the application of contract rules in Saudi Arabia is obscure in relation to investors aggrieved due to a defective prospectus. In the prospectus cases, the rescission remedy is absent from the CML’03. Rescission is not available for the investors who sustain loss or damage due to a defective prospectus. In fact, the serious dearth of cases and lack of interpretations of civil liability for prospectus make the issue more difficult.

However, the remedy of rescission has elsewhere been in decline because of the limitations imposed by the courts on its availability. Greg Golding outlines the instances where the right of rescission has been lost as follows:

i. If the investor does anything with the right to reject the contract to subscribe for shares after notice of misrepresentation is received by the investor;

ii. If the parties cannot be restored to their original position; and

iii. If the investor does not reject its shares within reasonable time of receiving notice of misrepresentation.

From the above, it can be seen that the right of rescission is available to investors who subscribe to the shares and do not make a later purchase, or to persons who subscribe through agents where they are an undisclosed principal. Although there has been a

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742 Securities Act 1933 (US) § 12(2); see Claude P Bordwine, 'Civil Remedies under the Texas Securities Laws' (1971) 8 Houston Law Review 657, 669.


744 Golding, above n 275, 204.

745 Ibid.
decrease in the demand for the right of rescission in developed jurisdictions, the lack of clear statutory contract remedy in Saudi Arabia makes its presence essential. Additionally, the absence of the right of rescission remedy in the CML’03 reveals the need for a statutory rescission remedy, which is necessary in order to have adequate investor protection in the IPOs.

6. 6 Persons Who are Entitled to Sue under the Civil Liability Provisions in Saudi Arabia

6.6.1 The Claim of Civil Liability

Firstly, it is important to find out who can utilise the civil liability provisions for claims in relation to a defective disclosure. Secondly, there is a need to clarify the difference between the terms ‘complaint’ and ‘case’ according to the *Regulating Procedures for Resolution of Securities Disputes of 2011* (RPRSD’11). Thirdly, there is also a need to recognise the procedure for bringing a complaint to the court.

Firstly, the injured investor has the right to seek compensation for the losses incurred due to the violation of the disclosure provisions. Thus, a private right suit enables investors to claim compensation for the losses that they have incurred as a result of the violation of the relevant provisions. In Saudi Arabia, the target of the lawsuit is whoever is proven to be guilty of violating those provisions regardless of their relationship with the company. A purchaser can claim for compensation according to art 55 of the CML’3, which states that in relation to a prospectus, the person who has purchased the security, which was subject to loss or damage due to the defect in disclosure, is entitled to seek compensation. Article 56 adds that a seller of a security can also seek compensation for loss or damage by stating that any person who was misled in relation to the sale or purchase of a security can seek compensation from the persons liable for
the violation of disclosure provisions. It can, therefore, be seen that the acquirers of securities — whether buyers or sellers — can sue for contravention of the disclosure requirements in the Saudi stock market. This is in line with the UK statutory regime of the *Financial Services and Markets Act of 2000* (FSMA 2000), which now is extended to include those acquiring interests in securities.\(^{746}\) For example, the Committee for the Resolution of Securities Disputes (CRSD) ordered a newspaper to compensate an investor for the loss he suffered because of an untrue statement regarding a listed company.\(^{747}\)

The defendant liability is joint and several.\(^{748}\) From the indemnitee’s perspective, joint and several liability is optimal because it ensures, among other things, the investor right to remedy for the loss or damage incurred because of the breach of the disclosure regime.

Secondly, there is difference between a ‘complaint’ and a ‘case’. It should be noted that the two words (a ‘complaint’ or a ‘case’) — particularly in terms of the application of these regulating procedures — are not used interchangeably in the Saudi securities laws, but are defined as follows:\(^{749}\)

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\(^{747}\) CRSD Decision No 508/L/D1/2009 of 1430 H issued 14 April 2009.

\(^{748}\) *Capital Market Law 2003* (Saudi Arabia) art 55(e) states that ‘the defendants are individually and jointly and severally liable for damages for which they are responsible under this Article’. According to the legal dictionary, joint and several liability is: A form of liability that is used in civil cases where two or more people are found liable for damages. The winning plaintiff in such a case may collect the entire judgment from any one of the parties, or from any and all of the parties in various amounts until the judgment is paid in full. In other words, if any of the defendants do not have enough money or assets to pay an equal share of the award, the other defendants must make up the difference. The Free Dictionary, Joint and Several Liability (7 November 2012) <http://legal-dictionary.thefreedictionary.com/joint+and+several+liability>.

\(^{749}\) For more details of these definition, see *Regulating Procedures for Resolution of Securities Disputes 2011* (Saudi Arabia) art 1.
Chapter 6: Investors’ Remedies

Complaint: is the process of filing with CMA a grievance or a claim of right or ceasing any invasion of right.

Case: is the complaint when registered with the committee, starting from presenting such a written initiatory pleading, under these regulating procedures, until the passing of the final and binding judgment.

In other words, the term ‘complaint’ means ‘submission of a grievance or seeking a right or making a defence against an assertion of the right’; but when the complaint goes from the CMA to the CRSD, it becomes a ‘case’. In general, any investor who realises that he/she has been a victim can bring the issue to the court. However, the investor has to go through the CMA first to lodge a complaint as this is the only way to ask for compensation.

Hence, if any person intends to make a claim, he/she must first submit the complaint to the Department for the Complaints of Investors within the CMA. Once such a claim is made, two things will be considered, as follows:

i. After a period of 90 days has elapsed from the date of submission of the complaint, the claimant becomes eligible to apply directly to the CRSD.

ii. The CMA notifies the claimant that he/she can advance the complaint to the CRSD before the end of the period of 90 days, then the claimant can take the complaint directly to the CRSD and then it becomes a lawsuit.
In addition, art 2 of the RPRSD’11 gives details of the process of filing a case with the CRSD.

To file a case with the committee, it is required to enclose a proof that the case is filed first with CMA, and period of 90 days had elapsed since such filing. However, a statement from CMA permitting filing with the committee before the elapse of such a period may be enclosed. The case shall deal with the same subject of the complaint filed with CMA.

It is clear from the above Article that a claimant is required to initiate the complaint with the CMA before taking the action to the court. From a practical point of view, it should make it easier for investors to sue companies for defective disclosures if a case was able to be brought directly to the court instead of going through the CMA. This procedure may delay the process of legal action against the alleged perpetrators. However, the following will discuss the securities class action lawsuit and its possible application in Saudi Arabia.

Source: The Capital Market Authority.\textsuperscript{750}

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6.6.2 The Absence of the Securities Class Action Lawsuit

The securities class action lawsuit is considered a form of legal remedy. This form of collective suit emanated from the US, which is a common law country. Class actions were a result of the development of the law to provide protection for the individual. They are group or representative proceedings which allow individuals or businesses with similar or substantially similar claims to combine together in one legal action against the same person or organisation. Hence, the US is the original ‘home’ of class actions generally, and securities class actions in particular. In addition, class action lawsuits are used in the courts of other jurisdictions of common law legal origins, such as the UK and Australia. Australian courts recognise that a class action is a radical form of legal procedure developed by the US courts. Most recently, some 6000 shareholders participated in a class action against the Centro Group and have been presented with a proposed settlement of AUD 200 million (USD 203.4 million) on allegations that Centro and its former auditors, PricewaterhouseCoopers, engaged in misleading and deceptive conduct and breached continuous disclosure laws.

751 The class action can be defined as: ‘a legal procedure that enables the claims (or part of the claims) of a number of persons against the same defendant to be determined in the one suit. In a class action, one or more persons (representative plaintiff) may sue on his or her own behalf and on behalf of a number of other persons (the class) who have a claim to a remedy for the same or similar alleged wrong.’ For more details see Rachael Mulheron, *The Class Action in Common Law Legal Systems: A Comparative Perspective* (Hart Publishing, 2004) 1.

752 Mordecai Rosenfeld, ‘The Impact of Class Actions on Corporate and Securities Law’ (1972) 1972 Duke Law Journal 1167, 1190. It is noteworthy to mention that although Rosenfeld admits the importance of the class action, he does suggest that not every class action is a worthy one.


However, it is noteworthy that class actions are not exclusively a device for common law legal systems.\footnote{Mulheron, above n 751, 5.} For example, Quebec in Canada, and Sweden and Brazil have developed, within their civil law systems, a formal doctrine for class actions.

The class action regime has several common objectives. US jurisprudence has particularly reiterated\footnote{United States Parole Comm'n v Geraghty, 445 US 388 (1980) 402–403.} that class actions protect defendants from inconsistent obligations that may be created by varying results in different courts, and, similarly, it promotes the equitable principle that similarly situated plaintiffs should receive similar recoveries.\footnote{Mulheron, above n 751, 49.}

The major purpose of class action lawsuits is to maintain market efficiency and integrity by deterring managerial misconduct in market affairs through the provision for compensation of shareholders for losses.\footnote{Mitchell, ‘The Innocent Shareholder’, above n 425, 246.} Moreover, Nicholls claims that securities class actions are an effective civil enforcement remedy.\footnote{Nicholls, above n 617, 368.} On the other hand, Coffee and Fox assume that there might be a harmful result of punishing other equally innocent investors in the same corporation when a civil action is raised by one group of shareholders seeking damages arising from secondary market disclosure violations.\footnote{John C Coffee, ‘Reforming the Securities Class Action: An Essay on Deterrence and its Implementation’ (2006) 106 Columbia Law Review 1534, 1537; Fox, ‘Civil Liability and Mandatory Disclosure’, above n 223, 296.}

Coffee and Fox declare that ‘[c]ivil actions brought by one group of shareholders seeking damages arising from secondary market disclosure violations may have the perverse effect of punishing other equally innocent shareholders of the same corporation’.\footnote{Ibid.} However, since the shareholder class action came into existence, it has

\footnote{Ibid.}
been an effective remedy for investors and a successful deterrent to corporations in regard to misleading shareholders.\textsuperscript{762} A recent study found that the private enforcement in Canada is weaker than that of the US and largely attributed this to the slow development of effective class action legislation in many Canadian provinces.\textsuperscript{763}

Under the Saudi securities law, investor class action suit has not yet been identified as possible. In practice, no legal action has been witnessed that has been brought by a group of investors against persons liable for violation of the disclosure regime. The introduction of a statutory securities class action would certainly benefit investor protection. For example, since the passage of the \textit{Private Securities Litigation Reform Act 1995} (US), which introduced the possibility of securities class actions, the likelihood of companies to be sued still rose 23 per cent in the period 1995–2004.\textsuperscript{764} In another example, Australian securities class actions have developed through legislative change over the last two decades and have been strengthened through recent developments in case law, which have helped clarify how and when they can be used.\textsuperscript{765}

Furthermore, the objectives of the class action are enormous and evident. Class action regimes might achieve economies of time, effort and expense, and promote uniformity of decision. It is also a meaningful remedy for large numbers of plaintiffs. A class action suit can reduce the cost for the courts and plaintiffs. In addition, there are non-common objectives of the class action. They are: giving the case more importance, providing deterrence against the potential wrongdoers, preventing the defendant from

\textsuperscript{763} Nicholls, above n 617, 384.
unjust enrichment, and requiring the wrongdoer to fully compensate the costs of their illegal activity.\textsuperscript{766} As a result of the above objectives, securities class action lawsuits have become more attractive to plaintiffs where such lawsuits are available.

On the basis of the above discussion, it can be said that the need for the availability of a securities class action lawsuit in Saudi Arabia is obvious for the sake of investor protection in the share market. As can be seen from the foregoing, the existing legal remedies remain inadequate in Saudi securities law; and investor protection, therefore, requires additional improvements and indeed reform.

\textbf{6.6.3 Statute of Limitations}

A statute of limitations sets forth the time within which an accrued cause of action must be asserted in court.\textsuperscript{767} If the plaintiff brings a suit after the statute of limitations has run, he/she has no legal remedy. A statute of limitations affects only a plaintiff’s ability to seek a remedy; it does not affect a plaintiff’s underlying rights.\textsuperscript{768} In this regard, a statute of limitations is distinguishable from a statute of repose, which extinguishes a plaintiff’s rights or prevents them from arising once a fixed period of time has passed.\textsuperscript{769} However, limitation is considered a bar on a plaintiff’s right to sue.

A statute of limitations exists under the CML’03. In response to a claim for a breach or violation of defective disclosure requirements, courts will not accept the case after the elapse of one year. So defendants does not need to be worried about such case, as they

\textsuperscript{766} For more details of the objectives of the class action regime, see Mulheron, above n 751, 63.


\textsuperscript{768} Ibid.

\textsuperscript{769} Ibid.
can rely upon a limitation period specified in the Law, as follows: 770 Article 58 of the CML’03 stipulates a limitation period of one year, commencing from when the complainant realised that he/she has become a victim of such a violation. This Article also stipulates that in any event, suit of action is barred after five years from the occurrence of the violation. 771 Moreover, in Saudi Arabia, art 27 in the RPRSD’11 772 clearly mentions one year as a limitation period, commencing from when the plaintiff realised that he/she has become a victim of a violation. Thus, the victim is required by law to submit a complaint against the wrongdoer within this twelve-month period, otherwise his/her right to initiate the action becomes worthless. Furthermore, once five years have passed since the said violation occurred, complaints will not be allowed to be heard before the CRSD.

The statute of limitations period specified in the CML’03 differs from that applying in the US and Australia (the provisions of which in this regard also vary from that of each other in terms of their basis and the periods involved). 773 The period limitation in Sarbanes-Oxley Act 2002 (US) (SOX’02) is two years after the discovery of the violation, with any action to be initiated no more than five years after such violation. The CA’01, however, provides that proceedings must be instituted ‘within 6 years after the day on which a cause of action arose’ (as the result of specific corporate misconduct). 774 Thus, the period of limitation in CML’03 is couched in the same terms regarding its basis as the US legislation but varies in terms of the period involved (the

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771 See *Capital Market Law 2003* (Saudi Arabia) art 58.
772 *Regulating Procedures for Resolution of Securities Disputes 2011* (Saudi Arabia). The issuance of this regulation occurred during the writing this thesis.
774 *Corporations Act 2001* (Cth) s 1325(4).
US being two years from the time of discovery, Saudi Arabia, just twelve months from the time of discovery; while the period for action from the date of the occurrence of the violation is common, that is five years). The period applying in Saudi Arabia differs from that provided not just in the US (as above) but also Australia (where action must be launched within six years of the violation occurring). Saudi Arabian legislation specifies just one year since the discovery of a violation (and within five years of the violation itself) as the time limitation for initiating a suit. In contrast, the corresponding law in Jordan requires that litigants must initiate suits within two years and the limitations period commences from the date of the sale of the securities.  

The limitations statute for a cause of action for claims of defective disclosures commences when the conduct occurs, unless the defendant has concealed it from the plaintiff, in which case, in most jurisdictions, the statute of limitations is tolled until the plaintiff either discovers the wrongful conduct or, through the exercise of reasonable diligence, should have discovered it. In this respect, Saudi Arabia and the US have agreed that the validity of the period of limitations for a lawsuit starts from the discovery of the violation. The Federal Court in the US held that ‘when the same statute which creates a cause of action also contains a limitation period, the statute of limitations not only bars the remedy but also destroys the liability. The plaintiff must therefore plead and prove facts showing that he is within the statute of limitations.’

According to the CML’03, the statute of limitation specifies a one-year limit in which plaintiffs are able to bring a case to court after they have become aware of facts causing

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775 Securities Law 2002 (Jordan) art 111(C).
776 While (for example) art 111(c) of the Jordanian Securities Law 2002 states that it does so from the date of the sale of securities
777 See Pennsylvania Co. For Insurances, ETC v Deckert, 123 F2d 979 (C.A. 3rd 1941); See Murray L Simpson, 'Investors' Civil Remedies under Federal Laws' (1962) 12 DePaul Law Review 75, 76.
them to believe that they had been the victim of a violation of law. However, in other jurisdictions, such as the US and Australia, two years are allowed for the action to be brought. Whilst the short period for bringing actions under the CML’03 may benefit the defendant, it is not in the best interest of investor protection.

In Saudi securities market, investors’ complaints have to be lodged with the CMA within one year, commencing when the investor realises he/she has been a victim of a violation. In addition, this complaint cannot be initiated after five years have elapsed since the discovery of such a violation. These limitation periods are considered a positive attribute of the Saudi securities regulatory system. Hence, the statute of limitations in Saudi securities laws is quite compatible with that of the developed securities laws of US and Australia. However, judicial decisions play a significant role in the interpretation of laws in the developed countries. For instance, the US Court of Appeals in *Securities and Exchange Commission v Rind* stated that enforcement claims brought by SEC are not barred by the statute of limitations.778

Under the Saudi securities laws, the current limitation period of one year to bring an action to the court is insufficient and contrary to investor protection. Taking into consideration the fact that having any limitation on the plaintiff’s right to sue is a disadvantage by itself, so having only one year to sue is not enough time for the injured investor. Although the one-year period starts from the time that the investor realises that he/she has been a victim of a violation of a law, it encourages wrongdoers to claim the investor’s had knowledge earlier in the period since the transaction or even at the time of the transaction, thus ruling out any claim (see further below). A claim for

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compensation might fail due to the defences that the defendants can uphold during the litigation. The next chapter will discuss the evidence rules and the defences to civil liability for violations of the disclosure requirements in Saudi Arabia.

6.7 Summary and Conclusions

The earlier discussion confirms the fact that there are inadequate remedies available to the investors to recover their damages or loss as a result of a breach of the disclosures regime in Saudi Arabia. Although the remedy of damages could be available to compensate the plaintiff’s loss resulting from violations of the disclosure regime in both prospectus and secondary market, it remains the only relief available to investors. A comparison with developed countries, such as the US, UK and Australia, demonstrates that there are statutory remedies other than damages available for investors to recover their losses in these jurisdictions, such as: rescission, the right to withdraw and have money returned, and the right to return the securities and be reimbursed the amount paid for those securities, thus offering higher protection for investors in those markets.

It has been found that the current civil liability regime in Saudi Arabia is insufficient to provide investor protection. Considering the statutory absence of the right to the rescission remedy and the lack of a securities class action lawsuit, this argument may be plausible.

It has been demonstrated that the securities class action is an effective remedy for aggrieved investors as well as a means of deterrence for potential violators. Nevertheless, the provisions for a securities class action do not exist in Saudi Arabia. Hence, shareholders who suffer minor loss or damage because of a breach of disclosure
regime are reluctant to sue the wrongdoers. As a result, violators go unpunished and victims sustain loss; and perpetrators may be encouraged to repeat their actions.

Furthermore, it has been demonstrated that giving a limitation period of one-year to the victim to sue is an obstacle to the plaintiff’s right to sue. It is recommended that the limitation period to be extended to two years as it is in the US or to six years as it is in Australia. Additional time will allow the plaintiff to bring the action to the court without being under time constraints. Investor protection will be increased by their having extra time to gain access to advice, marshal their resources and necessary evidence sue where a violation has occurred. Wrongdoers may then not as easily escape liability and investor protection will further rise as the deterrent value of the legislation would impact on potential actions or omissions that would be subject to such suits..

Based on the above, it can be clearly said that the civil liability regime for defective disclosures is insufficient under the current CML’03. These legal lacunae result in weaker investor protection of investors. The current disclosure regime is expected to foster the development of the securities market, but — as stated by some commentators — the weaknesses of the protection of public investment in the securities market have negative consequences for this development. Therefore, it is suggested that additional remedies should be available and accessible to aggrieved investors in the Saudi securities market. A report by the Technical Committee of the IOSCO noted that:

Statutory civil remedies for investors who have suffered harm because they relied on materially misleading, incomplete or incorrect information, are mechanisms used in some jurisdictions to provide greater protection to investors and to strengthen market discipline. Such remedies may make it easier for investors to establish a claim for recovery.

With greater investor protection available in a strengthened civil liability regime, it would then be essential to have adequate defences to avoid liability where this is undeserved. It is the achievement of such a balance that will encourage greater participation by investors in the country and the healthy development of corporations and the economy. With this in mind, the next chapter will investigate the provisions of defences and evidence in regard to civil liability for defective disclosures under the securities laws and regulations in Saudi Arabia.
CHAPTER 7: EVIDENCE AND DEFENCES WITH REGARD TO CIVIL LIABILITY FOR DEFECTIVE DISCLOSURES UNDER SAUDI SECURITIES LAWS

7.1 Introduction

The preceding chapters have discussed the civil liability provisions for defective disclosure in Saudi Arabia. It has been found that there are civil liability provisions for defective disclosure made in prospectuses and in continuous and periodic disclosure. In addition, the issue of investor remedies against breaches of the disclosure regime has been discussed. These previous chapters demonstrate that the provisions dealing with civil liability for defective disclosure are inadequate thus far.

A strong civil liability regime must provide sufficient remedies for aggrieved investors and make defences available to those who are accused of a breach of the disclosure regime. A ‘defence’ may be defined as the reason or justification for the defendant to avoid the claim of liability against him/her.\footnote{A balance is to be struck. ‘[t]he legislation seeks to balance investor remedies with allowing good faith transactions that violate statutory provisions’: Condon, Anand and Sarra, above n 237, 600.} Another definition is that defences are the means used by the defendant in the court to refute the plaintiff’s claim and so avoid liability.\footnote{Awad Ahmed Al-Zoubi, Civil Procedure (Wael House for Publishing, 2nd ed, 2006) [Arabic] 689.} The use of the defences made available under the law may allow a defendant to achieve their goal.

To measure the strength of the civil liability regime, defences in regard to civil liability for defective disclosures need to be discussed in detail. Therefore, this chapter will focus on the defences that are available to defendants to allow them escape civil liability. Then, arguments will be offered regarding the provisions that provide defences regarding civil liability for the breach of the disclosure regime and an evaluation of
them will be undertaken. The results demonstrate the inadequacy of the current civil liability regime for defective disclosures in Saudi Arabia.

Moreover, a significant issue is the important role played by the law of evidence in disputes arising from the securities market. As Islamic law (Shari‘ah) is the main source of laws in Saudi Arabia, there are no comprehensive and codified laws of evidence for civil litigations. However, there are procedural rules governing evidence in securities cases under the laws and regulations of the Capital Market Law 2003 (CML’03) and the Capital Market Authority (CMA). It is said that the current rules of evidence are inefficient and require improvement in order to strengthen civil liability regime for defective disclosure in the Saudi securities market. Thus the beginning of this chapter will demonstrate the inadequacy of the current rules of evidence concerning securities cases. It will analyse the provisions dealing with civil liability in terms of rules of evidence pertaining to securities litigation and the defences to civil liability that are available under the CML’03.

It is important to indicate that the discussion will be limited to defences available under the securities laws and regulation in Saudi Arabia. However, the experience of the selected developed (the US, UK Australia and Canada) will be used selectively throughout the text in order to improve their equivalents in Saudi Arabia.

To this end, the discussion is divided into six sections. Section 1 is introductory. Section 2 will look at the issues concerning evidence provisions in dealing with contravention of the securities disclosure requirements. Section 3 will discuss the defences available in civil liability for breaches of the prospectus requirements. Section 4 will then separately focus on due diligence as a defence under the civil liability provisions in Saudi Arabia.
Section 5 will explore the defences to civil liability for defective disclosure in the secondary market. Section 6 will present a summary and conclusions.

### 7.2 Evidence under the Securities Laws in Saudi Arabia

#### 7.2.1 Provisions Regarding Evidence in Dealing with Contraventions of the Securities Disclosure Requirements in Saudi Arabia

There is some coverage of the processes and use of evidence to be found in the Saudi securities law. Paragraph (i) of art 25 of the CML03 states that, ‘evidence in Securities cases shall be admissible in all forms including electronic or computer data, telephone recordings, facsimile messages and electronic mail’. This provision considers the technical nature of securities transactions, which involve prices and complicated standards.

Although the above provision regarding evidence may conform to the nature of these transactions, which are performed professionally and swiftly, it does not provide sufficient detail regarding the substantive and procedural rules of evidence. Furthermore, art 18 of the *Regulating Procedures for Resolution of Securities Disputes 2011* (RPRSD’11) deals with the forms of evidence similarly, reiterating the acceptable forms of evidence to be presented. This Article states that evidence may be presented to the Committee for the Resolution of Securities Disputes (CRSD) in all forms and by any means, ‘including electronic data or data extracted from computers, as well as telephone call recordings, fax correspondences and e-mails’. This provision of evidence allows the litigants in securities cases to utilise and present every form of evidence.

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783 The rules of evidence are divided into two: procedural rules and substantive rules. The procedural rules deal with rules followed in the path of proof and periods and deadlines. The procedural rules are obligatory on the judges and litigants and cannot be violated. On the other hand, the substantive evidentiary rules are concerned with determining the different evidence, the value, the subject of evidence and the burden of proof. For more details, see *Evidence and Enforcement* (16 May 2012) Philadelphia University, Jordan <http://www.philadelphia.edu.jo/law/sl/410492.pdf> 13. [Arabic].
However, a comprehensive law of evidence is absent from the Saudi Arabian legal system generally and more particularly in regard to securities contraventions. Therefore, it is submitted that investor protection will be undermined because of the significant shortcomings in the evidence provisions of the Saudi securities laws. Laws of evidence are a significant aspect of ensuring a fair trial for both the plaintiff and the defendant. The following discussion will demonstrate the importance of a comprehensive law of evidence for the application in securities litigation in Saudi Arabia and the need for its introduction.

7.2.2 Arguments for the Importance of a Law of Evidence in Saudi Securities Laws

Generally, having an adequate law to govern evidence during procedures contributes to a fair, quick and satisfactory decision by the court. The need for such law becomes imperative due to the nature of securities civil cases, where investors who have sustained loss or damage are involved. At this point, it is worth defining and recognising the concepts of the law of evidence, and its role in securities cases. Posner commences his study by stating that, ‘the law of evidence is the body of rules that determines what, and how, information may be provided to a legal tribunal that must resolve a factual dispute’.\(^\text{784}\) Moreover, Waight and Williams define the law of evidence as the law that ‘consists of the rules and principles which govern the proof of the facts in issue at a trial. The “facts in issue” are those that the plaintiff or prosecutor, and the defendant or accused, must prove in order to be successful’.\(^\text{785}\) Stone and Wells claim that the ultimate objective of the law of evidence is to ‘ensure that the facts found, to

which the court is to apply the rules of substantive law, are more likely to be true than false.\textsuperscript{786} 

In Saudi Arabia, the legal system is based on \textit{Shari’ah}, which is the law applicable in civil litigation. In \textit{Shari’ah}, as is the case in common law, the law of evidence is of great importance in any trial or legal adjudication.\textsuperscript{787} However, evidence in \textit{Shari’ah} means, ‘to make a plea in the court by the means set by Shari’ah’.\textsuperscript{788} In other words, evidence is presented to convince the court that you ‘own’ the right that is the subject of the dispute. A legal definition of evidence in Saudi Arabia’s laws has yet to be found. Also absent are statutory evidence rules to be applied on securities cases. Generally, the evidence rules in Saudi Arabia follow \textit{Shari’ah} in applying the evidence system and the burden of proof.\textsuperscript{789} There are no sufficient written rules, statutes or associated statutory ordinances or so forth to govern evidence. The only provisions for evidence are to be found in the \textit{Law of Procedure before Shari’ah Courts 2000} (‘Law of Procedure’ or LPSC’00). This law, however, governs evidentiary procedures only and disregards the substantive rules of evidence. In addition, judges have wider powers to determine the applicable evidence in the proceedings on the basis of \textit{Shari’ah}. However, it is unclear whether the provisions of this Law of Procedure apply to cases involving securities or not. Securities cases require proper and clear rules regarding the evidence and the burden of proof, both of which are currently insufficient or lacking in the securities law of Saudi Arabia. In contrast, most of the neighbouring Islamic countries have codified

\textsuperscript{787} Hussain, above n 72, 184.
Chapter 7: Evidence and Defences

the application of evidence based on Shari’ah as statutory rules.\(^790\) Without such a mechanism, the absence of a clear law of evidence in Saudi Arabia continues to contribute to making the issue more difficult for both the litigants and the court in securities cases.

7.2.3 The Burden of Proof\(^791\)

Proof is a crucial issue when matters are being decided between the plaintiff and the defendant as well as between the creditor and debtor, and where their various interests are being weighed. Therefore, lawmakers are interested in developing general rules of evidence with which all litigants must comply.\(^792\)

Usually in civil cases, the onus of proof is on the plaintiff.\(^793\) Similarly, in securities regulations, the plaintiff must prove a breach of the relevant securities laws. The defendant can certainly rely on available defences and usually must prove the defence. However, Condon, Anand and Sarra have noted that, ‘in the securities realm, the onus of proof when a defence is invoked is not always clear.’\(^794\) In some cases, it is clear that

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\(^790\) See for example, in Jordan, a neighbouring country of Saudi Arabia, there is the *Law of Evidence of 1952*; in Egypt the *Law of Evidence in the Civil and Criminal Litigations 1968*.

\(^791\) It is worth mentioning that evidence has to be presented in a clear, convincing and satisfactory manner. “Burden of proof” means the obligation of a party to meet the requirements of a rule of law that the fact be proved either by a preponderance of the evidence or by clear and convincing evidence or beyond a reasonable doubt’. See Rule 1(4) of the proposed uniform rules of evidence discussed by McBaine. For more details, see James P McBaine, 'Burden of Proof: Presumptions' (1955) 2 *UCLA Law Review* 13, 13–14.

\(^792\) In legal discussion the phrase ‘burden of proof’ is used in two ways:
1. To indicate the duty of bringing forward argument or evidence in support of a proposition, whether at the beginning or later; 2. To mark that of establishing a proposition as against all counter-argument or evidence: see James B Thayer, 'The Burden of Proof' (1890) 4 *Harvard Law Review* 45, 48.

\(^793\) That is, the task of proving a case on the balance of probabilities lies with the person asserting the law’s breach by another. The plaintiff must therefore present sufficient evidence to convince the court that this is so.

\(^794\) Condon, Anand and Sarra, above n 237, 598.
the defendant must prove that he, she, or it meets the requirements of the defence, but in other cases, the onus of proof is ambiguous. 795

The common law accusatorial system defines the burden of proof as, ‘the duty of one party (usually the party bringing the proceedings against another) to make out the case against the other party and to prove to the court that the case has been established’. 796

Another expression is ‘persuasive burden’, which is the burden of winning the mind of the person or persons who are charged with establishing the facts and with decision making, by the evidence, to those propositions of fact asserted by the party who will fail if those propositions are not accepted. 797

In the UK, in relation to prospectuses, the onus of proof is imposed on the persons who accept responsibility for the prospectus. Davies points out that,

A statutory regime has been in place since the Directors’ Liability Act 1890, the modern version of which is section 90 of FSMA. That regime imposes liability for negligence (with the burden of proof reversed) on issuers and directors (and others who have accepted responsibility for all or a part of the prospectus or listing particulars) in favour of those who acquire the securities and suffer loss as a result of the misstatement, whether or not they have relied on the prospectus. 798

In another example, a US court dropped a case initiated by the SEC for an injunctive action because the SEC failed to prove a breach of the securities law. 799 This demonstrates that the court imposed the burden of proof on the plaintiff. 800 Likewise, civil liability provisions in the CML’03 impose the burden of proof on the plaintiff. This can be seen from reading the relevant articles regarding liability for the prospectus,

795 Ibid.
796 Nygh and Butt, above n 105, 73.
799 See SEC v First Fin Group of Texas, 645 F 2d 429 (5th Cir, 1981) 434.
where the injured investor has to prove that he/she was not aware of that prospectus was
defective when purchasing the security.\textsuperscript{801} However, it does not identify the party who
must prove that the disclosure was defective. It is not clear whether the plaintiff has to
prove the existence of a false or misleading statement or omission.

The imposition of the burden of proof on the plaintiff becomes more evident in
secondary securities market contraventions.\textsuperscript{802} The person who claims damage or loss
because of the defective disclosures must prove the relationship between the
wrongdoing and the damage or loss incurred.

As is the case in the common law, \textit{Shari’ah} imposes the onus of proof on the plaintiff.
Where the plaintiff’s claim is accepted by the court, the defendant then has the
obligation to disprove to the claim.\textsuperscript{803} This is because the presumption of innocence
requires the plaintiff to prove that the wrongdoing is related to the defendant and this
wrongdoing in turn caused damage to the plaintiff.

By way of contrast, in contractual liability, any breach in the contract leads to the legal
assumption that makes the debtor a wrongdoer for merely not having implemented a
contractual obligation.\textsuperscript{804} On the other hand, common law misrepresentation actions in
corporate transactions generally require proof that the claimant reasonably or justifiably
relied on the defendant’s allegedly false statement.\textsuperscript{805}

\begin{itemize}
  \item\textsuperscript{801} See \textit{Capital Market Law 2003} (Saudi Arabia) art 55(a).
  \item\textsuperscript{802} Ibid 56(a).
  \item\textsuperscript{803} Hussain, above n 72, 186; Also see Al-Thanon, above n 273, 62.
  \item\textsuperscript{804} Bernadette Richards, Karinne Ludlow and Andy Gibson, \textit{Tort Law in Principle} (Thomson Reuters, 5\textsuperscript{th}
  \item\textsuperscript{805} Many contracts contain a ‘disclaimer-of-reliance’ provision that requires the buyer to agree that it did
not rely on any \textit{extra-contractual} representations made by the seller. For more details, see Glenn D West
and W Benton Lewis, ‘Contracting to Avoid Extra-Contractual Liability — Can Your Contractual Deal
Ever Really Be the “Entire” Deal?’ (2009) 64 \textit{Business Lawyer} 999, 1018.
\end{itemize}
Chapter 7: Evidence and Defences

In fact, a low burden of proof on investors favours the development of the market. There is a strong link between the development of securities market and a low burden of proof on investors joined with adequate disclosure requirements. Jackson and Roe observe that ‘[t]he development of stock markets is strongly associated with extensive disclosure requirements and a relatively low burden of proof on investors seeking to recover damages resulting from omissions of material information from the prospectuses’. Similarly, La Porta et al find that,

the development of stock markets is strongly associated with measures of private enforcement such as extensive disclosure requirements and a relatively low burden of proof on investors seeking to recover damages resulting from omissions of material information from the prospectus.

Based on the preceding discussion, it can be seen that evidence plays a central role in law. In the same way, evidence holds additional importance in securities disputes due to the nature, size and the number of investors in the share markets. This requires efficient regulations to be joined with an effective judicial system in order to conduct fair, rapid and low cost securities trials and hearings of civil suits. The earlier discussion of the provisions that govern evidence in civil liabilities for securities cases shows that these provisions are inadequate. The absence of a written and comprehensive code of evidence in the Saudi legal system has contributed to the creation of more ambiguity. Consequently, while there is not a comprehensive law of evidence to be referred to under the current CML’03, clear and sufficient wording of the substantive and procedural rules of evidence are obvious. In fact, such laws will certainly strengthen the civil liability regime for defective disclosures in Saudi Arabia. Improvements will be

806 Jackson and Roe, above n 675, 234.
807 La Porta, Lopez-De-Silanes and Shleifer, above n 4, 20.
Chapter 7: Evidence and Defences

thereby achieved in relation to the protection of investors from non-compliance with disclosure requirements in both primary and secondary share markets.

7. 3 Defences to Civil Liability for Defective Prospectuses in Saudi Arabia

In order to succeed under some defences, the person claiming protection under a defence must prove its applicability to him or her. The following discussion will concentrate on defences available to avoid civil liability for defective disclosures in the prospectus.

7.3.1 An Overview of Defences against Civil Liability for Defective Prospectuses in Developed Countries

In the selected developed countries, some argue that it is much easier for liability to attach, but this is balanced by the fact that it is also easier to establish a defence. However, despite the fact that developed countries avail the defendant more defences, their legal and regulatory framework and enforcement are stronger than that of Saudi Arabia. Therefore, investor protection is higher in these developed countries. The following will describe the defences to civil liability for defective prospectus in the developed countries.

The US, UK, Australia and Canada have a number of defences available against civil liability. However, a due diligence defence is available in these jurisdiction as defence against civil liability for defective prospectus. In addition to the due diligence, there are additional defences which are:

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808 Securities Act 1933 (US) § 11(b)(3); Financial Services and Markets Act 2000 (UK) c 8, s 90 ; Securities Act 1990 (Ontario) s 130(4); Corporations Act 2001 (Cth) s 731.
i. Lack of knowledge: if the defendant can prove that the document containing the misrepresentation was filed without his/her knowledge or consent.\textsuperscript{809}

ii. Plaintiff’s knowledge of the misstatement or omission at the time stocks were acquired or transaction made.\textsuperscript{810}

iii. Lack of causation: The defendant will not be liable if able to prove that the decline in the security’s value was due to a general decline in the market and was not a result of any untruths or omissions in the registration statement.\textsuperscript{811}

iv. Withdrawal of consent: a defendant can avoid liability if he/she can approve the withdrawal of consent before the issue of the prospectus.\textsuperscript{812}

v. Expert defence: this is defence for experts who believe that portion of the prospectus (for which they were responsible) was accurate and fair.\textsuperscript{813}

vi. Reliance on an expert: if the misrepresentation is contained in a part of prospectus made on the authority of an expert, the defendant must prove that he/she had no reasonable ground to believe and did not believe that there had been a misrepresentation in the expert’s opinion.\textsuperscript{814}

These defences are statutory defences, which are available in their securities legislations. Although the above defences are available to defendants, requirements for each defence limit their scope. This will be evident in the discussion of the due diligence defence in the selected countries and Saudi Arabia.\textsuperscript{815} As a consequence,

\textsuperscript{809} Securities Act 1990 (Ontario) s 130 (5)(a); Corporations Act 2001 (Cth) s 732.
\textsuperscript{810} Securities Act 1933 (US) §11(a); Securities Act 1990 (Ontario) 130(2); Financial Services and Markets Act 2000 (UK) c 8, s 90.
\textsuperscript{811} Securities Act 1933 (US) § 11(e).
\textsuperscript{812} Securities Act 1990 (Ontario) s 130(3)(b); Corporations Act 2001 (Cth) s 733(3).
\textsuperscript{814} Securities Act 1990 (Ontario) s 130 (3)(c); Corporations Act 2001 (Cth) 733(1); Financial Services and Markets Act 2000 (UK) c 8, s 90.
\textsuperscript{815} See Section 4 of this Chapter.
investor protection is weaker in Saudi Arabia due to its unclear due diligence defence which may permit wrongdoers to escape liability easily.

7.3.2 Defences Available under the Saudi Laws

There are a number of defences available to potential defendants in order to avoid civil liability for a defective prospectus in Saudi Arabia. Similarly to what applies in developed countries, the due diligence defence, lack of causation and plaintiff’s knowledge of the alleged breach defence can be found in the art 55 of the CML’03 which deals with the civil liability for defective prospectuses. However, the above description of defences available in selected developed jurisdictions shows that they have more defences than that in Saudi Arabia. But as has been discussed in the previous chapter, these developed countries have wider range of remedies than that in Saudi Arabia. The following will describe the defences available under the civil liability provisions for misstatement in or omission from the prospectus.

7.3.2.1 Due Diligence Defence

In Saudi Arabia, due diligence is available for potential defendants other than the issuer in regard to civil liability for defective prospectuses. It is noteworthy that the due diligence defence provisions in the CML’03 are equivalent to the US approach, but with fewer details included in the legislation. Therefore, the function of the due diligence defence in the CML’03 parallels the US approach to this topic. The issuer remains liable to investors for defective disclosures in a prospectus even if innocently made. In a

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816 Potential defendants in regard to a defective prospectus include: issuers, directors, senior officers, underwriters, accountants, engineers or appraisers and others identified in the prospectus, who have consented in writing to be so identified, as having certified the accuracy and truthfulness of the information stated in the prospectus. See art 55 of the Capital Market Law 2003 (Saudi Arabia).
number of other developed securities jurisdictions, the due diligence defence is available, under Code or common law in the respective type of jurisdiction. The UK, Australia and Canada provide the due diligence defence in their securities laws. The due diligence defence will be discussed in depth in a separate section of this chapter.

7.3.2.2 The Lack of Causation Defence

This defence is expressly provided in art 55(e) of the CML’03. Here defendants can be absolved from the liability for misstatement in a prospectus by proving that the plaintiff’s damages did not result from the misstatements or omission. Thus, according to art 55(e), a defendant can avoid or reduce the measure of damages by showing that all or any portion of the decline in value of the security was not caused by the violation in question.

In respect of the underwriter, art 55(b)(4) of the CML’03 provides that, in regard to a security for sale to the public, ‘an underwriter shall not be liable for more than the total price of the Securities underwritten or amount of Securities distributed by him (whichever amount is greater)’. Similarly, under the SA’33, the liability of the underwriter is limited to the total price at which the securities underwritten by him and distributed were offered to the public. US law practitioner in securities litigation, Howard Nations, states in this regard:

The defendant may assert that the lack of proximate causation — that the actions of a third party are the sole proximate or independent intervening causes of the

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818 Schedule 10 the Financial Services and Markets Act 2000 (UK); ss 731–733 of the Corporations Act 2001 (Cth); ss 130(3)–130(5) of the Securities Act 1990 (Ontario). In Australia, a person who is involved in the listed company’s contravention is also exposed to the civil penalty, subject to a due diligence defence. See Corporations Act 2001 (Cth) s 674(2A) Contravention by Individual Note 1: This subsection is a civil penalty provision. Section 674(2B) Due diligence defence applies if the person proves that they took all reasonable steps in the circumstances to ensure that the listed disclosing entity complied with its obligations and, after doing so, believed on reasonable grounds that the listed disclosing entity was complying with its obligations under s 674(2).
plaintiff’s damages. However, if the defendant could have reasonably foreseen the intervening cause, the chain of causation between the defendant’s negligence and the alleged damages is not broken, and the defendant is not relieved of liability for the plaintiff’s losses.\footnote{Howard L Nations, Remedies for Wronged Investors (17 November 2001) <http://www.howardnations.com/reading/wrongedinvestors.html> citing Restatement (Second) of Torts §§ 448 (1965).} Although the plaintiff is not required to prove loss causation in the complaint, he/she must show that the purchase of the securities was made directly in the initial offering not in the secondary market.

7.3.2.3 Plaintiff’s Actual Knowledge of the Alleged Breach

In regard to the prospectus, defendants\footnote{Potential defendants in prospectus include: issuers, directors, senior officers, underwriters, accountants, engineers or appraisers and others identified in the prospectus, who have consented in writing to be so identified, as having certified the accuracy and truthfulness of the information stated in the prospectus. See art 55 of the Capital Market Law 2003 (Saudi Arabia).} (including the issuer) can escape civil liability by proving that the plaintiff knew of the misstatement or omission at the time he or she acquired the security. Despite this defence being available as actual knowledge is an obvious concept, it is difficult to prove in reality because one cannot get into the mind of the plaintiff.\footnote{Todd R David, Jessica P Corley and Ambreen A Delawalla, 'Heightened Pleading Requirements, Due Diligence, Reliance, Loss Causation, and Truth-On-The-Market — Available Defenses to Claims under Sections 11 and 12 of the Securities Act of 1933' (2010) 11 Tennessee Journal of Business Law 53, 77.}

In the US, a Court of Appeal agreed and held that a plaintiff may not recover under § 11 if it knew [of] or had available ‘information that would have revealed the untruth or omission contained in the registration statement.\footnote{APA Excelsior III LP v Premiere Tech Inc, 476 F.3d 1261 (11th Cir, 2007), 1277.}

In Canada, the Securities Act 1990 (Ontario) (SA’90) and in Australia the Corporations Act 2001 (CA’01) have expanded the scope of defences to include a withdrawal of
Chapter 7: Evidence and Defences

consent\textsuperscript{823} and a lack of knowledge defence. Lack of knowledge as a defence provides that if the person did not know that there was a misstatement in the disclosure document, liability will not arise. The ‘withdrawal defence’ differs from the lack of knowledge as the defendant is required to prove that he/she withdrew his/her consent to the issue of the prospectus (or relevant part thereof). More specifically, the withdrawal defence can be claimed in two stages. The first stage is the receptive director has to prove that they withdrew their consent to be a director before the issue of the prospectus and the prospectus was prepared and issued without their consent. In the second stage, the defendant can prove that the issue of the prospectus in question was made without their knowledge or consent and they immediately withdrew their consent and provided public notice to that effect. For example, s 732 of the CA’01\textsuperscript{824} states that in order to escape civil liability, the defendant needs to prove that they did not know that the statement was misleading or deceptive, as did s 130(3)(a) of the SA’90 for those in that Province’s jurisdiction.

In contrast, art 56(a) of the CML’56 only states that ‘the claimant should prove that he was not aware that the statement was omitted or untrue’. The CML’03 does mention lack of knowledge as a defence and the law has not provided the withdrawal defence. In addition, the CML’03 needs to stipulate the withdrawal of consent as well as to what

\begin{footnotesize}
\footnote{Securities Act 1990 (Ontario) ss 130(3)(a) and 130(3)(b); Corporations Act 2001 (Cth) ss 732, 733.}

\footnote{Corporations Act 2001 (Cth) s 732 – Lack of knowledge defence for offer information statements and profile statements. Not knowing statement misleading or deceptive:

(1) A person does not commit an offence against subsection 728(3), and is not liable under s 729 for a contravention of subsection 728(1), because of a misleading or deceptive statement in an offer information statement or profile statement if the person proves that they did not know that the statement was misleading or deceptive.

Not knowing there was an omission:

(2) A person does not commit an offence against subsection 728(3), and is not liable under section 729 for a contravention of subsection 728(1), because of an omission from an offer information statement or profile statement in relation to a particular matter if the person proves that they did not know that there was an omission from the statement in relation to that matter [emphasis added].}
\end{footnotesize}
stage the defendant has to prove that he/she was not aware of the that prospectus in question was defective. Further, withdrawal of consent should have been made public in order to enable the investors to make an informed investment decision and to protect potential investors from being misled. In fact, the current CML’03 provisions do not require a notice to be given the public by the defendant, providing that the prospectus in question was issued without his/her knowledge or consent. The purpose of such a notification is investor protection and the integrity of the market.

Briefly, in the case of a defective prospectus, civil liability is subject to specific defences under the Saudi laws. Defendants other than the issuer can also escape liability by establishing the due diligence defence. In addition, defendants can avoid civil liability by proving the lack of causation and/or the plaintiff’s actual knowledge of the defective nature of the prospectus. However, taking into account the importance of the due diligence as a defence, the following section will be dedicated to discussing the due diligence defence in more detail.

7.4 Due Diligence as a Defence under the Saudi Securities Law

The expression ‘due diligence’ means ‘close examination … of a transaction and its related documentation’.

This expression is always used in the legal sense of a transaction and its related documents. In *Universal Telecasters (Qld) Ltd v Guthrie*, it was held that ‘due diligence’ refers to a standard of behaviour, which is then able to be used to defend oneself against the breach of regulatory and supervisory provisions; that is, the appropriate persons must ensure that the particular system was properly carried out. Having an adequate system (policy and procedures) in place to prevent

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825 Nygh and Butt, above n 105, 170.
826 (1978) 18 ALR 531; 32 FLR 360.
contravention of relevant legislation or to ensure compliance with the prevailing regulatory schemes can be crucial to a defence as can be the provision of adequate supervision to ensure such a system is maintained or correctly utilised.\textsuperscript{827} Additionally, a crucial issue with due diligence is that persons involved in a transaction or documentation must exercise their powers and carry out their duties with appropriate care and diligence. Failure at any of these points can lead to a failure of the defence. However, the following discussion of the due diligence defence under the CML’03 demonstrates that the current situation in Saudi Arabia in respect of the application of the due diligence defence remains ambiguous.

7.4.1 Due Diligence Defence and the Persons Involved in the Prospectus

7.4.1.1 Due Diligence Defence for Defective Prospectus Available to Persons Other than Experts

Article 55 (c)(1)(2) of the CML provides a due diligence defence for those persons who can be held liable for defective disclosures in a prospectus.\textsuperscript{828} The defence can be used to establish whether the section in question is certified by experts or not.

Firstly, for any section of the prospectus not certified by an expert, persons liable (that is, one other than the expert but who was authorised or was responsible for the document or portion thereof) may claim the due diligence defence by showing that he/she: (1) conducted a reasonable investigation, and (2) had reasonable grounds to believe or (3) actually believed that there was no material omission or misstatement.\textsuperscript{829} In other words, a showing of due diligence requires that such a person demonstrate that,

\textsuperscript{827} Ibid 363.
\textsuperscript{828} These persons are:
1. Senior officers of the issuing party of the security
2. Directors or persons performing similar functions
3. The underwriters.
\textsuperscript{829} Capital Market Law 2003 (Saudi Arabia) art 55(c)(1).
Chapter 7: Evidence and Defences

‘after reasonable investigation’, and on the basis of ‘reasonable grounds’, he/she was convinced that there were no misstatement or omission of material facts in such portions of the prospectus. Thus, these portions of the prospectus are referred to as ‘non-expertised’ parts.

The requirement for ‘reasonable investigation’ regarding non-expertised portions included in the prospectus is clearly established and required by the developed jurisdictions, such as the US, UK and Australia. For example, § 11(3)(A)–(B) of the SA’33 requires the defendants to perform reasonable investigation if they were to rely on the defence of due diligence. In Australia, s 731(1)(2) of the CA’01 asserts the requirement for ‘reasonable inquiries’ and ‘reasonable belief’ for the due diligence defence in regard to prospectuses. In the pursuit of the due diligence defence, the person ‘must always conduct the due diligence investigation in person’.

Secondly, there is the expertise defence. If the misleading statement or omission is in a section certified by an expert, anyone other than the expert can use the due diligence by showing only that he/she had no reasonable grounds to believe that there was a material misstatement or omission. Hence, it can be clearly seen that a ‘reasonable investigation’ standard applies to non-expertised portions and a ‘reasonable reliance’ standard applies to expertised portions.

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830 ‘[A]ll inquiries (if any) that were reasonable in the circumstances’: Corporations Act 2001 (Cth) ss 741(1)(a) (commission); 741(2)(a) (omission).
831 That is, in relation to statements then made being convinced they were correct or none omitted: Corporations Act 2001 (Cth) ss 741(1)(b) (commission); 741(2)(b) (omission).
833 Capital Market Law 2003 (Saudi Arabia) art 55(c)(2).
834 This comes in with US court’s interpretation of § 11 of the Securities Act 1933 (US), which held that the two portions of the prospectus cannot be treated the same for the purpose of the due diligence defence. Escott v BarChris Construction Corp, 283 F Supp 643 (SDNY 1968) 683.
7.4.1.2 Due Diligence Defence for Defective Prospectus Available to Experts

The due diligence defence is available to experts in respect of their opinions and reports. Certifying experts and others specified in the prospectus will be excused from liability for the section they certify if they can show that they conducted a reasonable investigation and had reasonable grounds for their belief that there was no material omission or misstatement in the section they certified. This standard is exactly the same as that which applies to non-experts in non-expertised sections of the prospectus.

7.4.2 The Drawbacks in the Due Diligence Defence for Civil Liability under the Capital Market Law 2003

Under the civil liability provisions in the CML’03, the due diligence defence is only available in regard to the prospectus. It is not accessible to all defendants in the secondary market. However, although the due diligence defence is available to defendants other than the issuer in regard to avoiding civil liability for defective disclosures in the prospectus, the application of this defence remains quite obscure under the CML’03. Several items demonstrate the ambiguity of this defence in Saudi Arabia. The first is the ambiguity of the standard of ‘reasonableness’ of due diligence. Second, the standards of ‘reasonable reliance’ and ‘reasonable investigation’ have not yet been developed, especially by courts. The third is the applicability of the due diligence to the ‘inside’ (executive) and ‘outside’ (non-
executive) directors. In all of the above items, it should be mentioned that the dearth of cases and lack of judicial interpretations of the due diligence defence have contributed to making the issue more difficult in Saudi Arabia.

To begin with, similar to § 11(c) of the SA’33, art 55(d) of the CML’03 states that the standard of reasonableness for due diligence shall be ‘that of the prudent man in the management of his property’. The question of whether the standard is met or not may be examined when determining the applicability of the due diligence defence. Therefore, it is important to have a clear understanding of the standard of reasonableness. In contrast to the US, this standard has not been developed by the CMA. In the US, the standard of reasonableness has been further developed by the US Securities Exchange Commission (SEC). In 1982, the SEC adopted Rule 176 under the SA’33 to identify certain circumstances in relation to persons other than the issuer, which circumstances could have an effect on the reasonableness of the investigation and thus allow a defendant to avoid liability for a defective prospectus. In the US, Rule 176 clearly delineates the circumstances that determine whether an inquiry is ‘reasonable’ and provides ‘reasonable grounds for belief’ under § 11.

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838 A ‘director’ refers to every member of the board of directors. See Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority 2004 (Saudi Arabia).
839 The Saudi securities regulator has exactly adopted § 11(c) of the Securities Act (US), which provides that: ‘In determining what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.’
841 The Rule confirms that the degree of investigation is not the same for all § 11 persons. The availability of the due diligence defence depends on the following factors:
1. type of issuer;
2. type of person;
3. type of security;
4. if the person is an officer, the office held;
Chapter 7: Evidence and Defences

The above shows the importance of the role played by the regulator in clarifying the law. While the Saudi law has adopted § 11 without change, it has not introduced clarifying rules similar to those which exist in the US, from which jurisdiction it adopted the initial section of the legislation. On the contrary, the standard of reasonableness has not been amended or developed by the Saudi regulator. It has not also interpreted by courts. Sjostrom has analysed several US court cases regarding the standard of reasonableness.\textsuperscript{842} He finds that the reasonable investigation standard applicable to underwriters is lower than the standard applicable to inside directors/management.\textsuperscript{843} Hence, the more direct a role a party plays, the more stringent the standard of liability.\textsuperscript{844} This sliding scale approach comports with the US Supreme Court’s statement in \textit{Herman & McLean v. Huddleston} that §11 ‘was designed to assure compliance with the disclosure provisions of the [Securities] Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering’.\textsuperscript{845} Another example, the US court in \textit{Monroe v Hughes}, states that even though accountants have to comply with the strictures of the accounting profession, the reasonable investigation standard is applicable to accountants.\textsuperscript{846}

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

\textsuperscript{843} Ibid.
\textsuperscript{844} Ibid.
\textsuperscript{845} 459 US 375, 381-82 (1983).
\textsuperscript{846} 31 F3d 772 (9th Cir. 1994).
Therefore, in the face of this insufficiency in regulatory and court interpretation under Saudi law, it would be opportune to adopt clear criteria for a ‘reasonableness’ standard in respect of what constitutes ‘reasonable’ investigation and ‘reasonable’ ground. Such improvements would strengthen the due diligence defence and contribute to the execution of justice.

Under the provisions of the CML’03, the due diligence defence is insufficient because of the vague position of non-executive (‘outside’) directors with respect to the due diligence defence. Generally, a company has executive and may also have non-executive directors. In Saudi Arabia, a company may have executive and/or non-executive directors. According to art 55(b)(3) of the CML’03, there is no distinction between the executive and non-executive directors with respect to prospectus liability defences.

It has been stated that the directors are required to meet the standard of reasonable investigation in order to accept the due diligence defence. Hence, expert defence that is available to executive directors in relation to material approved by executive directors for inclusion in reports is not enough to establish a due diligence defence. For instance, a due diligence defence was refused by an Australian court, saying that the ‘blind acceptance’ of assurances concerning disclosures in a prospectus given by the executive directors, amongst others, would not be acceptable. Another court in the same jurisdiction admitted this defence when the non-executive directors are just required to

847 ‘Executive director’ is a director engaged by a company under a contract of employment to perform functions additional to those involved in being a member of the board of directors. ‘Non-executive director’ or ‘outside director’ is a director who does not take part in the day to day management of the company. For more details, see Nygh and Butt, above n 105, 195 and 341.

848 J P Coats v Crossland (1904) 20 TLR 800, 806.
have ‘a reasonable ground’ to believe that the director of the issuer has carried out a reasonable investigation.\footnote{Stevens v Hoare (1904) 20 TLR 407, 409.} In *Adams v Thrift*, a leading English case, the court held that ‘blind reliance’ on a report or opinion by experts for prospectus statements was not a reasonable ground to establish the due diligence defence. Accordingly, directors must take positive steps in regards to the statements embodied in the prospectus in order to ascertain their reliability before approving their inclusion.

On the other hand, in regard to victims, a Canadian academic, Christopher C Nicholls (commenting on the legislation applicable to the Province of Ontario), supports the removal of the requirement that they prove a reliance upon the material pivotal to the dispute. He commends a statutory civil liability remedy, which eliminates the requirement for aggrieved investors to prove reliance on the alleged misrepresentation and would represent a powerful protective tool for Ontario investors.\footnote{Nicholls, above n 617, 393. Note: He refers only to Ontario investors as this legislation is limited to the Province of Ontario, Canada, and is not national legislation.}

Furthermore, it is generally known that executive directors are associated with the affairs of the company more than the non-executive directors. Thus, the executive directors are generally elsewhere ascribed to bear a greater due diligence obligation than the non-executive directors, as is apparent in the US case of *Escott v BarChris Construction Corp (BarChris Case)*, a leading case on the due diligence defence in that jurisdiction.\footnote{In this case it was held that: ‘What constitutes “reasonable investigation” and “reasonable ground to believe” will vary with the degree of involvement of the individual, his expertise, and his access to the pertinent information and data. What is reasonable for one director may not be reasonable for another by}
Chapter 7: Evidence and Defences

circumstances, a reasonable investigation cannot end with the questioning of company officials but must include independent verification of their answers.853

As well as noting the ‘need to retain some system of issuer liability under Section 11 — with a strong emphasis on insider [executive officer and executive director] responsibility’, US academic Donald C Langevoort adds that an ‘internal due diligence requirement for insiders makes a great deal of sense to [him]’.854 The inherent obligations of non-involved executives in this respect can also exert a social pressure for all to conform as their own liability would make them less likely to ignore lapses of others if they detect them. In terms of non-executive directors (‘outside directors’), Langevoort again calls to retain outside directors liability directly under §11 of the SA’33 when scienter can be established.855 Most recently, the Australian High Court in the James Hardie case held that non-executive, as well as executive directors, are responsible for the release of information concerning company decisions to the share market, employees, creditors and the public.856

In fact, the position of the non-executive directors is important in relation to the management of the corporation. In respect of the causes of corporate scandals and malfunctions generally, DeMott argues that the main one of these causes is the

cite{Escott v BarChris Construction Corp, 283 F Supp 643 (SDNY 1968) 706.}

cite{Escott v BarChris: "Reasonable Investigation" and Prospectus Liability under Section 11 of the Securities Act of 1933 (1969) 82 Harvard Law Review 908, 910.}

cite{Langevoort, ‘Deconstructing Section 11’, above n 540, 64.}

cite{Ibid 65. Langevoort notes that the 1995 reforms the eliminated of joint and several liability and balanced due diligence responsibilities in §11 liability as such persons were ignorant of any fraud.}

cite{To fail to do so as required is to fail in their duties to the company and breach their legal obligations under the Corporations Act. Matters concerned related to the adequacy of asbestos compensation funding, company planning and share arrangements. See Australian Securities and Investments Commission v Hellicer (2012) HCA 17; Shafron v ASIC (2012) HCA 18; Australian Securities and Investments Commission, Decision in ASIC’s Appeals in James Hardie Matter (16 May 2012) <http://www.asic.gov.au/asic/asic.nsf/byheadline/12-85MR+Decision+in+ASIC’s+appeals+in+James+Hardie+matter?openDocument>.}
malfunctions resulting from inadequate performance of non-executive directors in relationship to the corporation’s senior management. However, the following discussion aims to show the need for clear and developed provisions regarding this defence.

In the UK, under the Companies Act 2006 (CA’06), the law clearly applies to all directors, whether executive or non-executive, full or part-time, and that a director can be liable for the actions of his/her fellow directors. Accordingly, a director must ensure that he/she is regularly provided with sufficient information to satisfy himself/herself that he/she and his fellow directors are fulfilling their obligations.

However, it can be said that the exercise of reasonable inquiry is crucial in order to confidently approve the accuracy of some portions of the prospectus. It is, however, suggested that regardless of the degree of involvement of directors, they could not be free from defective prospectus liability on the basis of due diligence without at least exercising reasonable care. The blind acceptance of others’ statements will not be adequate to establish this defence. From the above, it has been shown that in developed jurisdictions generally the ‘reasonable investigation’ standard varies according to the type of defendant. The more direct a role a party plays, the more stringent the standard of liability.

858 Companies Act 2006 (UK) ss 171–177 – the general duties and on directors both fiduciary and non-fiduciary.
860 Sjostrom, above n 842, 572.
In Saudi Arabia, however, as there is no distinction between the executive directors and non-executive directors, the application of due diligence remains ambiguous. In addition, other jurisdictions have made the burden on the executive directors far more onerous than that on the non-executive directors in establishing the due diligence defence, as is evident from the above. Consequently, the drawbacks associated with the lack of clarity regarding the due diligence defence and a lack of cases to illustrate its operation will certainly lead to weakening of the regime of civil liability and actually undermine the concept of investor protection in the IPO market.

7.5 Defences to Liability for Defective Disclosure in the Secondary Market

The failure to make timely disclosure regarding periodic statements or continuous disclosures of new matters and developments related to the company may lead to loss or damage to investors in the share market. Persons responsible for such failure will be held civilly liable for defective disclosures. According to art 56 of the CML’03,

Any person who makes, or is responsible for another making, orally or in writing an untrue statement of material fact or omits to state that material fact, if it causes another person to be misled in relation to the sale or the purchase of a Security, shall be liable for compensation of the damages.

7.5.1 Lack of Causation as a Defence for Secondary Market Liability

It is clear from the above provision that the failure in making correct disclosure must be the cause that leads the potential plaintiff to sustain loss or damage. Thus, the result of loss or damages must be linked to the wrongful act. Thus, as in prospectus liability, defendants can avoid their liability by showing the lack of causation in regard to second market liability. The defendant can use the lack of causation in this regard to defeat a
claim by showing that the loss sustained by the plaintiff was not the result of the alleged misstatements or omissions.

However, the burden of proof is shifting from the defendant to the plaintiff. It puts more pressure on the plaintiffs to prove that their loss or damage is linked to a specified person who is assumed to be a potential violator of the disclosure requirements. Article 56 of the CML’03 states that when establishing responsibility for damages, the claimant should prove:

i. That he/she was not aware that the statement was omitted or untrue.

ii. That either he/she would not have purchased or sold the security in question had he known that information was omitted or untrue, or that he would not have purchased or sold such a security at the price at which such a security was purchased or sold.

iii. That the person responsible for the disclosure of the statements, or the giving of such incorrect information, knew of the said untruthfulness or was aware that there was a substantial likelihood that the information disclosed, omitted or misstated a material fact.

These provisions do not require the plaintiff to show any causal connection between the misrepresentation and his damage. Under art 56, the burden of proof is placed on the plaintiff. Thus, the plaintiff has to prove the damage and then courts determine its amount.
Chapter 7: Evidence and Defences

Under the US *Securities Exchange Act 1934* (SEA’34), a substantial burden of proof is placed on the plaintiff to prove that a defendant acted scienter (‘with knowledge’).\(^{861}\) Like the CML’03, it imposes the burden of proof for the damage on the injured investor (plaintiff) whilst the defendant has the burden of defence.

In Canada, s 138.4(2) of the SA’90 is similar in content to art 56, which states that a plaintiff has the burden of proof in relation to the failure of making timely disclosures. Nevertheless, the defendants have a number of defences in relation to the failure of timely disclosures if that person or company proves that the plaintiff acquired or disposed of the issuer’s security with knowledge of the defective or material change.\(^{862}\)

In addition, the defendant can escape liability for defective secondary market disclosures by establishing the due diligence defence.\(^{863}\)

In the same way, art 10 of the *Market Conduct Regulations 2004* (MCR’04) (Saudi Arabia) confirms that the plaintiff has the burden of proving the case.\(^{864}\) Hence, art 56

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\(^{861}\) David, Corley and Delawalla, above n 821, 60; *See Tellabs Inc v Makor Issues & Rights Ltd*, 551 US 308 (2007) 313.

\(^{862}\) *Securities Act 1990* (Ontario) s 138.4 (5)(6).

\(^{863}\) Ibid s 138.4 (6)(b).

\(^{864}\) See *Market Conduct Regulations 2004* (Saudi Arabia) where arts 10(c) and 20 provide defences to civil liability for a defective disclosure.

In art 10(c) for the purposes of application of art 56 of the *Capital Market Law 2003* and the provisions of this part: provide as follows:

**Article 10(c).**

A person shall be liable for damages to a claimant, if he is obliged under the *Capital Market Law*, the Implementing Regulations, or the rules of the Exchange or the Depositary Centre, to make a statement and fails to do so provided that:

1) The claim for damages is in relation to the purchase or sale of a security; and
2) What has been omitted relates to a material fact.

d. A claimant for damages under paragraph (c) of this Article must establish that:

1) He was not aware of the failure to make the statement; and
2) He would not have purchased or sold the security in question had he known in advance that the statement was omitted, or that he would not have purchased or sold the security at the price at which such security was purchased or sold.

**Article 20:**

Where a person is found to have violated the provisions of the *Capital Market Law* or the implementing regulations on market manipulation, insider trading or untrue statements while acting on behalf of another person and at the direction of the person on whose behalf the relevant act is
Chapter 7: Evidence and Defences

of CML’03 provides that the plaintiff has to prove that they were not aware that the statement in question was omitted or untrue. In this situation, the plaintiff carries the burden of proof. In Canada, s 138.4 of SA’90 presents a clear and direct provision regarding the liability. It provides a due diligence defence for the defendant to avoid civil liability. On the other hand, the plaintiff is required to prove that the failure to make timely disclosure by the person or company was done with their knowledge, or misconduct in regard to their knowledge of a material change that may affect the security’s value.

In Canada, amendments to the SA’90 that came into effect in 2005 allow secondary market purchasers to sue reporting issuers, officers, directors, spokespersons and others for violation of specified continuous and timely disclosure requirements. According to the above recent amendments, the amount of damages that can be claimed is limited unless the plaintiff can establish the defendant’s prior knowledge of either the misrepresentation or the failure to make disclosure of material change. For example,
Chapter 7: Evidence and Defences

in the IMAX claims in Canada,⁸⁶⁸ the plaintiffs have alleged that the defendants had prior knowledge of the misrepresentations and have therefore claimed damages of CAD 500 million and CAD 200 million in damages, alleging that the limits on damages do not apply to the defendants. Therefore, in many cases the extent of damages recovered will depend on whether prior knowledge can be established.

In the US, under the SEA’34, the lack of prior knowledge defence is clearly found in § 18. According to this section, civil liability for misleading statements is imposed on the wrongdoers, unless the person sued shall prove that he acted in good faith and had no prior knowledge that such statement was false or misleading.

However, according to art 56(a) of CML’03, the defence of lack of knowledge is unclear in respect of who can rely upon this defence to escape civil liability. Additionally, the application of this defence has not been interpreted by courts, which makes the issue difficult for the claim of civil liability for defective disclosures. Following the path of the recent amendments of the SA’90, the defence of ‘lack of knowledge’ is required to be improved and presented in efficient way.

7.5.2 Lack of Authorisation Defence

There are some measures available to defend liability, such as the ‘lack of authorisation’. Although this defence can be used as a defence against liability in general, it can be in addition used to avoid liability for defective disclosures. In fact, as with the lack of causation defence, this defence can be used to defend any defective disclosure whether it has occurred in the primary or secondary markets.

⁸⁶⁸ Ibid.
Chapter 7: Evidence and Defences

According to art 20(2) of the MCR’04, the defendants can avoid civil liability by proving that they did not authorise the person who acted on their behalf to carry out the action in question. This provides that when acting on behalf of another person and at the direction of the person on whose behalf the relevant act is undertaken, that person becomes liable and is subject to any sanctions to which the person carrying out the relevant acts is subject, unless the person on whose behalf the act is carried out proves that he has taken reasonable steps to prevent the violation of the law; or did not authorise the acts in question.869

The lack of authorisation defence that allows the defendant to avoid liability is ambiguously presented. The defendant ought to prove both that he/she, firstly, has taken reasonable steps to prevent any violation of the law, and, secondly, did not authorise or give authorisation to that person who claims to have acted on behalf them in regard to the act in question. Although this defence is provided by the MCR’04, it is broad and obscure. This is because it is not stated whether the defendant needs to prove the above two requirements of the defence jointly or separately, or whether just one of them alone is enough. Equally importantly, this defence lacks interpretation in terms of the conduct in question and also in terms of who acts on behalf the defendant. It does not identify the legal frame entitling this person to act on behalf of the other person. Further, the ambit of this authorisation is ambiguous.870

869 Market Conduct Regulations 2004 (Saudi Arabia) art 20(2).
870 In this respect, it would be more convenient if the Saudi securities regulator specifies who is the person who has authorisation to act on behalf the others who give him/her this authorisation or permission to do so such as ‘issuer agent, financial advisor, accountant, lawyer, auditor…’ and so on; it also does not specify that kind of permission or authorisation (comprehensive, partly or for a specific matter).
7.6 Summary and Conclusions

The main prerequisite for a sufficient and developed market is to have adequate laws. The law interferes in the securities market to provide protection to investors from unfair practices.\textsuperscript{871} The CML’03 was established with the objective of protecting investor interests, ensuring orderly and equitable dealing in securities, and promoting and developing the capital markets.\textsuperscript{872} The foregoing discussion demonstrates that the civil liability regime for defective disclosure in Saudi Arabia is ambiguous, lacks clarity and is narrow when compared to that of other selected developed countries, such as the US, the UK and Australia. The inadequacy has been measured in terms of the evidence in civil liability litigation and the defences to civil liability for defective disclosures.

The discussion of the evidence in civil liability litigation shows that there is no comprehensive written code of evidence under the Saudi legal system. In addition, although the current provisions dealing with the evidence under the CML’03 have procedural rules regarding that evidence, the Saudi system lacks the substantive rules that are imperative for the law of evidence and the concept of a fair trial.

Unlike other developed countries, the due diligence defence is only available for defendants in contravention of prospectus requirements. Thus, defendants are not able to uphold the due diligence defence against civil liability for defective disclosures in the secondary market.\textsuperscript{873} Moreover, there is a significant lack of interpretations regarding the ‘reasonableness’ standard, that is, what constitutes ‘reasonable investigation’ and

\begin{footnotesize}
\textsuperscript{871} For example, in the US, ‘the main purpose of the \textit{Securities Act} of 1933 is to protect financial markets investors by requiring disclosure in public offerings of securities.’ See Roberta Romano, ‘Empowering Investors: A Market Approach to Securities Regulation’ (1998) 107 \textit{Yale Law Journal} 2359, 2367; Lopez, above n 724, 655.

\textsuperscript{872} Ramady, above n 104, 158.

\textsuperscript{873} Disclosures in the secondary market are: periodic disclosures and continuous disclosures.
\end{footnotesize}
‘reasonable grounds’. This is coupled with the issue of missing criteria, namely what constitutes a reasonable investigation and reasonable grounds in respect of the defence of due diligence. In addition, non-executive director liability is not found under the current regime and therefore it is not clear whether the non-executive directors are able to use the due diligence defence or not. Thus, the definition of ‘reasonable inquiries’ is yet to be determined in respect of the non-executive directors. This is due to the fact that the current articulation of art 55 of the CML’03 does not have a clear distinction between the executive and non-executive directors in respect of the defences against prospectus liability.

It has been found that, under the CML’03, the defences for civil liability for a defective prospectus is equal to that of § 11 of the SA’33 In the case of a defective prospectus, a defendant other than the issuer can use the due diligence defence. In addition, defendants can escape liability by proving that the plaintiff knew of the misstatement or omission at the time he/she acquired the security, or proving that the plaintiff’s damages did not result from the misstatements or omission. Although the due diligence defence is clearly similar to § 11 of the SA’33, its application in Saudi Arabia remains poor.

Another drawback in the defences regime is that the due diligence defence is not available to defeat claims made under civil liability for defective disclosures other than in the prospectus. Under the current civil liability provisions, defendants are only able to establish the due diligence defence in the defective disclosures in a prospectus.

Conversely, in Canada for instance, s 138.4 (6)(b) of the SA’90 provides the due diligence defence to all defendants regarding a failure to make timely disclosure. Further, in the system of continuous disclosures, due diligence provisions do not detail
who in particular can rely on the defence. Section 674(2B) of the Australian CA’01 contains a clear indication of due diligence defence that can be relied upon by defendants in regard to continuous disclosures violations.

In Saudi Arabia, defendants may escape civil liability for breaches of secondary market disclosures. This is evident from the articulation of the civil liability provisions under the CML’03. Article 56 of the CML’03 provides the defendant with the defence of lack causation. What is more, it is unclear whether one can assume that implied defences are available for defendants due to the lack of interpretation of this Article by the regulatory and judicial bodies.

Furthermore, according to art 56 of the CML’03, the onus of proof is imposed on the plaintiff. Although the investor totally carries the burden of proof, he/she is not required to show any elements of causation in defective disclosures made in the secondary market. This is a supportive approach for investors and strengthens their right to be compensated for their affected investments. Nevertheless, art 56 does provide the defendant with the defence of the lack of causation to escape liability.

Based on the above, it can be clearly seen that these legal lacunae result in a weaker civil liability regime and are contrary to the concept of protecting investors. The previous discussion demonstrates that the provisions regarding defences are not clear. Taking into account the insufficient remedies available for aggrieved investors, wrongdoers may escape liabilities and investors remain uncompensated. With this in mind, the need for interpretations by the regulator and judicial bodies is evident in the development of the civil liability regime. The absence of judicial opinions regarding the

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defences available to civil liability for defective disclosures has contributed to making the issue considerably more difficult for investors who believe themselves victims to receive redress and, on the other hand, easier for defendants to avoid liability.

Indeed, fewer defences are recommended to allow investors to recover their loss. On the other hand, more defences will undoubtedly go against investor protection. In sum, despite the fact that defences are available under the current civil liability provisions in Saudi Arabia, the weak legal and regulatory framework and the ineffective enforcement mechanism make the issue difficult for injured investors to seek compensation for the loss or damage they sustain due to a violation of the disclosure regime. The Saudi securities market has a serious lack of experienced and well trained judges and lawyers. Hence, defendants can benefit from the weak regulations and enforcement machinery in the Saudi securities market and escape liability.

The absence of court decisions and judicial interpretation makes the issue difficult under the Saudi securities legislation. In contrast, it has been seen that the selected developed countries have a long history of dealing with securities cases and of judicial interpretation. Clear and improved civil liability provisions for defective disclosures are essential for the right to fair trial. However, drawbacks in judicial enforcement will demonstrate further weaknesses of the law relating to the disclosure. With this end in mind, the next chapter will investigate the provisions of judicial enforcement of the disclosure regime and civil liability resulting from the breach of disclosure requirements.
CHAPTER 8: JUDICIAL ENFORCEMENT OF THE SECURITIES LAWS AGAINST VIOLATIONS OF THE DISCLOSURE REQUIREMENTS IN THE SAUDI SECURITIES MARKET

8. 1 Introduction

The law is made to be enforced. Law enforcement represents the execution of the purposes contained in a given law. The judicial enforcement of law stands for the execution of those purposes through the government’s judiciary. There are two benefits of any law. The first benefit of any law relies on voluntary compliance with it. The second benefit of a specific law becomes more evident in its compulsory enforcement by the competent authorities. Lopez-de-Silanes notes that ‘[l]aws that stay on the books and are not enforced are tantamount to not having regulation at all.’

A large international study found that a strong level of enforcement of shareholders’ legal rights is essential in order to have effective corporate governance in emerging markets. Thus, the effectiveness of legal institutions is much more important than the quality of the law in the books.

In respect of the securities market, the enforcement of corporate laws is crucial to the maintenance of market integrity and sustainability. A study of 49 countries selected from different legal systems found that the primary market has been considerably improved by effective law enforcement. Closing remarks in this survey confirm that countries with a low level of law enforcement lack development of their securities

878 Rafael La Porta et al, 'Legal Determinants of External Finance', above n 19, 1143-1146; La Porta, Lopez-De-Silanes and Shleifer, above n 4, 28.
Chapter 8: Judicial Enforcement

markets. In addition, Johnson affirms that ‘[l]egal institutions are strongly correlated with financial development’ of a country’s economy. A report from the World Bank asserts that ‘[e]ffective institutions can make the difference in the success of market reforms.’ Strong judicial institutions that enforce contracts will create an attractive environment for funds and deter those who would wish to engage in risky or dubious business activities.

More importantly, the adequacy of the judicial enforcement is significant in terms of the protection of investors. Effective judicial enforcement is the cornerstone of public confidence in the judiciary. Klapper and Love state that ‘[f]irm-level protection of minority rights is less likely to be effective if legal enforcement and judicial efficiency is weak.’

In effect, corporations alone cannot provide a safe investment environment for their shareholders. While the separation between the corporate shareholders and management of corporations gives corporations an advantage over the structures, it raises significant conflict of interest between shareholders and managers. The conflict arises because managers of corporations are more concerned about increasing their own personal salaries, or job security rather than in the interests of investors who wish the value of their corporation to increase and the share price (and return on their investment) to rise. Thus, both issuers and shareholders rely on an efficient legal system to protect their

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879 Rafael La Porta et al, 'Legal Determinants of External Finance', above n 19, 1149; La Porta, Lopez-De-Silanes and Shleifer, above n 4, 28.
880 Johnson, above n 668.
882 Ibid.
883 Klapper and Love, above n 556, 717.
interests. A weak environment of enforcement will not only undermine the corporate governance mechanisms, but also the general financial development of corporations.  

As the aim of the disclosure regime is to provide protection for investors, corporations are responsible for their compliance with disclosure requirements in the prospectus, periodic disclosures and continuous disclosures. A breach of disclosure requirements may result in damage or loss for the investors. Victims of such breaches may seek judicial enforcement in order to remedy their loss or damage. Accordingly, a speedy and cost-effective delivery of judgments is expected to provide justice to all litigants.

In Saudi Arabia, securities market participants increasingly demand judicial reforms. It is argued that the judicial enforcement of corporate laws is inadequate in Saudi Arabia. Evidence will be presented to demonstrate that currently the judicial dealings with securities market disputes are weak and reasons for this situation will be presented. There are calls to enhance the role of the Capital Market Authority (CMA) in bringing civil suits on behalf of the investors. In addition, the articulation of the securities court’s remedial powers or sanctions is not clearly provided in the Capital Market Law 2003 (CML’03). Moreover, the securities courts in Saudi Arabia lack not only efficient judges, but also experienced lawyers, who are essential for the maintenance of effective securities regulation. Additionally, despite the fact that there are special courts for the adjudication of securities disputes, the independence of these courts and judges is questionable. For that reason, a number of commentators confirm that ‘[t]he

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884 Erik Berglöf and Stijn Claessens, 'Enforcement and Good Corporate Governance in Developing Countries and Transition Economies' (2006) 21 World Bank Research Observer 123, 124.

885 The terms ‘sanction’ and ‘remedy’ will be interchangeably used to indicate the court’s potential decisions as specified under art 59 of the Capital Market Law of 2003 (Saudi Arabia).
Chapter 8: Judicial Enforcement

A combination of judicial independence and efficiency seems to be essential for judicial reforms to have a positive effect on economic development.\textsuperscript{886}

The objective of this chapter is to discuss the shortcomings of the judiciary when dealing with securities cases from the perspective of investor protection. The discussion in this chapter will be divided into seven sections. Section 1 provides an introduction. Section 2 outlines the objectives of the judicial enforcement of the securities laws. Section 3 describes the judicial system for securities litigation in Saudi Arabia. Section 4 provides an evaluation of the judiciary dealing with the securities litigation. Section 5 provides an evaluation of the current performance of the securities courts in Saudi Arabia. Section 6 discusses and evaluates the drawbacks associated with the powers of the securities courts. Section 7 presents a summary and conclusions, which demonstrate that the current judicial enforcement of the disclosure regime is ineffective in protecting investors in the Saudi securities market, and reforms in this respect are of vital importance.

8.2 Objectives of the Judicial Enforcement of the Securities Laws

The fundamental goal of the enforcement of law is to maintain order in a country. This is also true in relation to securities markets, which require more than just having law ‘on the books’ in order to ensure the effective functioning for such markets. Precise enforcement of law provides deterrence for potential violators. The quality of law enforcement refers to the effectiveness of the judicial system in redressing the violation of law.

\textsuperscript{886} Juan Carlos Botero et al, 'Judicial Reform' (2003) 18(1) \textit{World Bank Research Observer} 61, 80.
There are different views regarding the goals of the enforcement of securities laws. Some of the prominent goals that have been adopted by the Canadian Securities Administrators (CSA)\(^{887}\) state that the purpose of enforcement of securities laws is to ‘deter wrongdoing, protect investors, and foster fair and efficient capital markets in which investors have confidence’.\(^{888}\) In Australia, an empirical study found that the central approach amongst judges regarding the goal of the enforcement of corporate law is to ensure honesty and the compliance with standards of morality and proper conduct in corporate activities.\(^{889}\) The majority of judges agreed that the primary goal of enforcement of securities laws is the protection of the investing public.\(^{890}\) Moreover, legal practitioners consider the enforcement of securities laws ‘as a means of creating market confidence and ensuring that business operates smoothly’.\(^{891}\) Furthermore, Stigler states that ‘the goal of enforcement is to achieve that degree of compliance with the rule of prescribed (or proscribed) behaviour that the society believes it can afford’.\(^{892}\) Law and finance theory emphasises that the efficiency of the enforcement of the law has a great influence on the development in terms of the breadth and depth of the capital market, the efficiency of investment allocation, the nature of corporate

\(^{887}\) ‘The Canadian Securities Administrators (CSA) ‘is a voluntary umbrella organization of Canada’s provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets’: Canadian Securities Administrators, 'Introduction to Canadian Securities Administrators', above n 405.


\(^{890}\) Ibid 200–1.

\(^{891}\) Ibid 202.

structures and so on. These, in turn, largely hinge on public confidence in the securities market, which is again underpinned by effective enforcement.\(^{894}\)

The above collected views suggest that the protection of investors is the main goal of the enforcement of securities laws. This protection relies heavily on the judiciary. Therefore, effective judicial enforcement of securities laws requires efficiency and expertise within the judiciary system in order to produce effective protection of investors.

In Saudi Arabia, a special judiciary has jurisdiction over all securities disputes. The Committee for the Resolution of Securities Disputes (CRSD) was established by the CML’03 to have exclusive jurisdiction over disputes and courses of action arising under the CML’03 and its appurtenant rules and regulations. The law grants the CRSD a broad range of authorities and powers in order to effectively enforce the law and maintain fairness amongst securities market participants. However, there are claims that the judiciary is ineffective in regard to securities litigation. It is argued that an independent and experienced judiciary for the settlement of securities disputes is of paramount importance for judicial effectiveness. A successful legal system requires efficient and experienced judges to promote the judicial enforcement of the law. Equally, a proper judicial enforcement program can encourage greater adherence to the law and also boost public confidence in the enforcement machinery.\(^{895}\)

\(^{893}\) Rafael La Porta et al, 'Investor Protection and Corporate Governance', above n 19, 7.  
8. 3 The Judicial Institutions for Securities Litigation

The CML’03 initiated special committees\(^\text{896}\) to deal with breaches of its provisions and the rules of the CMA. These committees are quasi-judicial bodies; their decisions are regarded as judicial rather than administrative. Their final decisions cannot be appealed to any other judicial body.\(^\text{897}\) The independence of this judicial system for securities litigation is regarded as the collective or institutional independence of these quasi-judicial committees from the judicial branch of the government.\(^\text{898}\) Thus, these committees have different judicial procedures from those applicable to other judicial bodies in the country. Due to their role being essentially judicial in nature, the term ‘court’ will be used (below) in relation to them.\(^\text{899}\) The CRSD functions as the court of first instance (or first degree court) and the Appeal Committee for the Resolution of Securities Conflicts (ACRSC) as the appellate (or second degree) court.\(^\text{900}\) The following will provide a description of the judicial system that governs securities litigations.

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\(^{896}\) The term ‘committee’ is used by the CML’03 and the CMA. In this thesis, and because of the similarity between the roles of these committees and courts, the term ‘court’ will be used instead of ‘committee’.

\(^{897}\) In Saudi Arabia, there are a considerable number of quasi-judicial committees. Some of these committees have their decisions as final, and other committees’ decisions can be appealed to another judicial body. The reason for establishing these judicial committees is explained by Al-Ghadyan in his study of the legal system of Saudi Arabia:

There are several administrative committees with judicial powers. These committees were established as a result of the Shari’a Courts judges’ unwillingness to apply Government regulations, fearing that they may contain provisions that are not in strict compliance with the Shari’a Law. Therefore, wherever a new regulation is issued as a response to the requirement of the country’s social and economical development, it provides for the establishment of a committee whose task is to implement its provisions.


\(^{899}\) In general, the term ‘securities courts’ will be also used to indicate the committees dealing with disputes arising from securities market in Saudi Arabia.

Chapter 8: Judicial Enforcement

8.3.1 Composition of the Courts Dealing with Securities Litigations

Two bodies have jurisdiction over securities disputes in Saudi Arabia. Pursuant to art 25 of the CML’03, these are the CRSD and the ACRSC. The CRSD and ACRSC are fully independent in the discharge of their duties. Thus, pursuant to the provisions of the law, the CRSD and ACRSC became the competent bodies for litigation related to the resolution of cases between parties in disputes arising among investors and broker companies as well as the regulating and executing bodies of the Exchange Market.\(^{901}\)

8.3.1.1 Committee for the Resolution of Securities Disputes (CRSD)

The first CRSD began operating in 2004. Article 25(a) of the CML’03 enables the CMA to establish a committee known as the CRSD. The CRSD is a court of first instance, composed of members who are appointed under a CMA board resolution for a renewable three-year term.\(^{902}\) The law does not stipulate a particular number of CRSD members. However, the members of these committees will be discussed separately after highlighting the jurisdictions and powers of the CRSD.

8.3.1.1.1 Jurisdictions of the CRSD

The CRSD has exclusive jurisdiction over disputes and causes of action arising under the CML’03 and its associated rules and regulations.\(^{903}\) It considers hearing all cases

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\(^{901}\) Committees for the Resolution of Securities Disputes, Q & A (11 December 2012) <http://www.crsd.org.sa/En/Pages/QA.aspx>.

\(^{902}\) \textit{Capital Market Law 2003} (Saudi Arabia) art 25(a)( b). CRSD first undertook its functions on 07 Dhu al-Qa’da1425 H (19 December 2004 G.), when CMA Board decision No 2-31-2004 dated 07 Dhu al-Qa’da1425 H (19 December 2004 G.) was issued to appoint CRSD members for their first term. Three were assigned as CRSD members: one is a chairman, and two are members. The assignment of all first-term members was renewed for a second term of three years, as per decision No 1/2/2008 dated 06 Muharram 1429 H (14 January 2008 G. The assignment of all current members of the CRSD was renewed for a further period of three years, as per CMA Board decision No 6/31/2010 dated 24 Dhu al-Hijja1431 H (30 November 2010 G).

\(^{903}\) Specifically, the CRSD ‘shall have jurisdiction over the disputes falling under the provisions of this Law, its Implementing Regulations, and the regulations, rules, and instructions issued by the Authority.
Chapter 8: Judicial Enforcement

involving the securities deposit centre,\textsuperscript{904} private causes of action under the CML’03,\textsuperscript{905} and enforcement and criminal actions brought by the CMA.

Since the CML’03 stipulates rules for various cases, the CRSD carries out its jurisdictions to review suits in accordance with such rules. The subject matter of CRSD jurisdictions can be summarised as follows:

i. Review claims against decisions taken and procedures adopted by the CMA or the Saudi Stock Exchange (SSE) — such a suit is known as an ‘Administrative Suit’;\textsuperscript{906}

ii. Review complaints arising between investors relating to the CML’03 and its implementing regulations, as well as CMA and the SSE regulations, rules and instructions in terms of public (filed against violators of the CML’03 and its implementing rules as well as of CMA regulations, instructions and directives) and private actions (filed by investors against authorised persons) — such a suit is known as a ‘Civil Suit’;\textsuperscript{907}

iii. Consider suits brought by the CMA (as a general prosecutor) against violators of the CML’03 and its implementing regulations — such a suit is known as a ‘Penal Suit’.\textsuperscript{908}

\textsuperscript{904} Ibid art 26: The Securities Depository Centre is the sole entity in the Kingdom authorised to practise the operations of deposit, transfer, settlement, clearing and registering ownership of Saudi Securities traded on the Exchange.

\textsuperscript{905} See also in ibid: Liability for material misrepresentation in a prospectus: art 55; Liability for material misrepresentation in purchase or sale of a security: art 56; Liability for market manipulation: art 57; Unlicensed brokers: art 60; General jurisdiction of the CRSD: art 62;


\textsuperscript{907} Ibid. For material defining private and public actions, see also the Committee for the Resolution of Securities Disputes, \textit{‘Q & A’}, above n 901.

\textsuperscript{908} Committee for the Resolution of Securities Disputes, \textit{‘CRSD Jurisdictions and Authorities’}, above n 906.
These subject matter jurisdictions are currently exercised at a broad geographical level, covering all the cities and governorates of Saudi Arabia, with the CRSD acquiring jurisdictional competence with regard to these authorities.

8.3.1.1.2 Powers of the CRSD

The CML’03 gave the CRSD broad jurisdiction, enabling it to maximise the performance of this jurisdiction and comprehensively review and resolve disputes. Article 25(a) of the CML’03 states: ‘The Committee shall have all necessary powers to investigate and settle complaints and suits, including the power to issue subpoenas, issue decisions, impose sanctions and order the production of evidence and documents’.

The powers granted to the CRSD are as follows:

i. to investigate and settle complaints and suits,

ii. to issue subpoenas,

iii. to make and issue necessary decisions to resolve the suit,

iv. to impose sanctions,

v. to order the presentation of evidence and documents,

vi. to issue a decision awarding damages, and

vii. to request a reversion to the original status, or issue another decision as appropriate that would guarantee the rights of the aggrieved.

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909 Ibid. The geographical jurisdiction is not mentioned in the CML’03. However, art 25 of the CML’03 empowers the CRSD to have jurisdiction over all claims arising from dealings in the Saudi securities market.

8.3.1.2 Appeal Committee for the Resolution of Securities Conflicts (ACRSC)

Paragraphs (g) and (f) of art 25 of the CML’03 provide for the formation of an appeal panel (the ‘Appeal Committee for the Resolution of Securities Conflicts’ (ACRSC)) to respond to requests for appeals against decisions issued by the CRSD and submitted within 30 days from the date of notification of the decision to be appealed.

The ACRSC is formed by a resolution of a Council of Ministers and is comprised of three members, each with a three-year renewable term, who represent the Ministry of Finance, the Ministry of Commerce and Industry, and the Bureau of Experts at the Council of Ministers.911 The inaugural ACRSC commenced in 2005, when a Council of Ministers’ resolution stipulated the membership of the ACRSC for its first term.912

The creation of the ACRSC came as an extension in order to ensure the right of litigants involved in securities disputes to obtain a number of guarantees. Such guarantees may include the right of appeal. Thus, the party who is unconvinced of the decision issued by the CRSD (court of first instance) may appeal such a decision before the ACRSC (appellate court), which consists of members different from those of the court of first instance.

8.3.1.2.1 Jurisdictions of the ACRSC

The ACRSC is considered an extension to the subject matter jurisdiction that the CRSD holds and as is set forth in art 25(a) of the CML’03. Thus, the ACRSC has geographical jurisdiction, where it proceeds with a spatial jurisdiction that includes all parts of Saudi

912 Members comprised three persons, namely a chairman and two other members: Res No 222 dated 22 Sha’ban 1426 H (26 September 2005 G). The tenure of two of the three first-term members was extended to a second term via resolution No 328 dated 05 Dhu al-Qa’d 1429 H (3 November 2008 G).
Arabia. The ACRSC has a subject matter jurisdiction over requests for appeals of decisions issued by the CRSD regarding complaints that arise between investors relating to the CML’03 and its implementing regulations, as well as the CMA and the Exchange Market regulations, rules and instructions in terms of public and private actions — such an action is known as a ‘Civil Suit’. The ACRSC also considers requests for appeals of decisions issued by the CRSD brought by the CMA against violators of the CML’03 and its implementing regulations — such an action is known as a ‘Penal Suit’. Additionally, the ACRSC reviews requests for appeals of decisions issued by the CRSD in terms of complaints and grievances resulting from decisions and procedures issued by the CMA or the Exchange Market — such an action is known as an ‘Administrative Suit’.

8.3.1.2.2 Decisions of the ACRSC

Requests for appeal on decisions issued by CRSD are made to the ACRSC. Under paragraph (g) of art 25 of the CML’03, the ACRSC may, at its discretion, choose to

(i) refuse to review a CRSD decision;

(ii) affirm the original decision; or

(iii) undertake a review (based on the record of the first instance hearing) and issue an ‘appropriate decision’.

The nature of the decisions of the ACRSC shall be final and cannot be appealed.
8.3.2 Members of the CRSD and ACRSC

The above description of judicial institutions for securities litigations in Saudi Arabia notes that there are two courts: the CRSD and the ACRSC. There are some differences in regards to the requirements for membership of the two bodies and the processes involved for appointment.

First, the members of the CRSD (the number members of which is unspecified) are appointed by a decision of the CMA Board. Article 25(b) of the CML’03 defines the requirements to become a member of the CRSD.\textsuperscript{919} Hence, the member shall be:

i. a legal advisor who specialised in the area of securities markets;

ii. an expert in commercial and financial matters and securities;

iii. appointed for a three-year term;

iv. must not have direct or indirect financial or commercial interest with the parties to the complaint or the suit brought before the CRSD;

v. must not have a family relationship up to the fourth degree with the parties to the complaint or the suit brought before the CRSD.

Secondly, and in contrast with the CRSD, the CML’03 stipulates that the three members of the ACRSC are appointed by a decision of the Council of Ministers.\textsuperscript{920} The CML’03 does not define the specific requirements for the members of the ACRSC (other than their representative status of particular Ministries and the Bureau of Experts). Article 25(g) states that:

i. the ACRSC is to consist of three members;

\textsuperscript{918} Capital Market Law 2003 (Saudi Arabia) art 25(g).
\textsuperscript{919} Ibid art 25(b).
\textsuperscript{920} Ibid art 25(g).
Chapter 8: Judicial Enforcement

ii. the three members are the representatives of the Ministry of Finance, the Bureau of Experts and the Ministry of Commerce and Industry.

iii. the members are to be appointed for a renewable three-year term.

8. 4 Evaluation of the Judiciary for the Adjudication of Securities Litigations in Saudi Arabia

The preceding description shows that the judicial institutions having jurisdiction to deal with securities litigations are independent of the government. The CML’03, as the sole securities legislation, has created the securities courts and defined the jurisdictions of those courts. The courts have both civil and criminal jurisdictions. These courts are empowered by the CML’03 to set down appropriate compensation and penalties in all cases brought before them, as stipulated in the pertinent laws. Moreover, these specialised courts have absolute jurisdiction over securities cases.

However, the effectiveness of each court’s operation is important in order for it to be able to dispense justice and maintain confidence amongst market participants. Many have argued that the quality of justice is measured by the quality of judges.\(^\text{921}\) It is not just a matter of what penalties are available, but of the willingness of the judiciary to impose them. It is also a matter of the training received for the extensive responsibilities (outlined above) that they bear. The members of the securities courts in Saudi Arabia have broad powers ranging from imposing monetary penalties to imprisonment.\(^\text{922}\)


\(^{922}\) In 2009, the CRSD issued a final decision of a three-month term of imprisonment against the chairman of the board of directors of Bishah Company. The imprisonment was as result of a securities violation (insider trading) and was the first such instance of jailing a violator of stock market rules. See Capital Market Authority, 'Announcement Regarding Bishah Agricultural Development Corporation' (Media Release, 13 January 2007) <http://www.cma.org.sa/Ar/News/Pages/CMA_N276.aspx> [Arabic]. He was also fined SAR 52,690 and banned from working with any listed firm for 5 years: Reuters Staff, 'Saudi Court Gives First Jail Term for Stock Market Violation', Reuters (online), 18 August 2009 <http://blogs.reuters.com/financial-regulatory-forum/2009/08/18/saudi-court-gives-first-jail-term-for-
Chapter 8: Judicial Enforcement

Therefore, the members of the securities courts in Saudi Arabia have extensive powers given to them by the CML’03.

Any evaluation of the efficiency of the securities courts requires an analysis of the adequacy of the judges who administer the justice, in terms of their numbers as well as training. In Saudi Arabia, although the CML’03 established specialised courts to have exclusive jurisdiction over breaches of the CML’03 and the regulations and rules issued by the CMA, shortcomings persist. Thus, the sufficiency and efficiency of the judiciary with respect to securities cases will be investigated in order to demonstrate that the securities courts in Saudi Arabia are both insufficient and inefficient.

8.4.1 Insufficient Number of Courts Dealing with Securities Cases

The earlier description shows that there are special courts in place to deal with securities cases. Decisions of these courts are final and cannot be appealed in any other judicial body. Both the first-instance court (the CRSD) and, the appellate court (the ACRSC) presently consist of three members. Despite the growing securities market and burgeoning economy, there is only one first-instance court located in Riyadh (the capital city of Saudi Arabia), as well as a single appellate court also located in that same city.923

That there are no other such courts in the other cities of the country can be considered to be a significant obstacle for those market victims who cannot afford the travel costs to make a claim for their loss or damage.924 Providing equal access to justice, regardless of

923 In 2010, the population of Riyadh region reached 6.8 million, which represented 25% of the total population of the country: Central Department of Statistics and Information Saudi Arabia, above n 59.
924 Any person who is directly involved in the case or has an interest in it, may file it to CRSD in person at any given stage from filing and pleading before the court up to the handing over of decision. He may appoint others to file the case on his behalf during any of the case stages. See Committee for the
geographical location, is significant in order to achieve a quality justice system.\textsuperscript{925} Without such access, victims may become reluctant to lodge their claim or may not be able to claim for their loss or damages, and wrongdoers thus escape their liabilities. Having just one bench of three members to deal with all securities allegations arising from the market can impair the effectiveness of judicial enforcement of securities laws in general, and of the disclosure regime in particular.\textsuperscript{926} A former general legal advisor of the CMA commented that as the CMA is responsible for the establishment and formation of courts for securities disputes and provides the financial support for these courts, there should be securities courts in all regions of the country rather than there being just one court located in Riyadh.\textsuperscript{927} He suggested that having extra securities courts in different regions would foster investor confidence and increase investment in the market.\textsuperscript{928}

For instance, in Australia, securities cases can be heard in the State courts and the Federal and family courts under the general cross-vesting legislation at Federal level that is complemented by legislation in every state and the Northern Territory.\textsuperscript{929} The original rationale for the cross-vesting scheme is still relevant: it provides ‘a beneficial facility … for the efficient use of hard-pressed resources and the reduction of

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\textsuperscript{926} The following Section 8.5 demonstrates the poor performance of the securities courts in Saudi Arabia.
\textsuperscript{927} Abdullah Albsalei, 'Legal Excesses by the CMA Lead to Investors Fleeing', \textit{Aleqtisadiah} (online), 26 November 2011 <http://www.aleqt.com/2011/11/26/article_601506.html> [Arabic].
\textsuperscript{928} Ibid.
\textsuperscript{929} This was upheld in a series of cases including \textit{Gould v Brown} (1998) 15 ACLC 316, 346; although the constitutionality of a number of elements was later challenged in other cases, including \textit{Wakim} and \textit{Hughes}, where the authors cite \textit{Re Hakim} (1999) 17 ACLC 1055 and \textit{R v Hughes} (2000) 18 ACLC 394: This led to further legislative change as detailed in Tomasic, Bottomley and McQueen, above n 545, 27–8.
\end{flushright}
inconvenience, delay and cost to litigants’.\textsuperscript{930} It is particularly applicable in the Saudi Arabian legal context as the country lacks physical infrastructure and enjoys perhaps the advantage of not having the additional complexities provided by a federal system. Accessibility of courts is vital to ensure legal redress for victims of violations of securities laws.

It is worth noting that Saudi Arabia has recognised the problem, with its legal system having been recently improved in respect to the laws governing the judiciary. The \textit{Law of Judiciary 2007}\textsuperscript{931} (LJ’07) was implemented to foster the fair demographical distribution of judges and courts across all provinces in order to satisfy an essential element of judicial effectiveness.\textsuperscript{932} In terms of securities related matters, however, despite the CML’03 establishing special courts for such cases, an insufficient number of courts and judges continues to persist, as is evidenced by the description and composition of these courts as provided in art 25 of the CML’03.

Although the CML’03 does not fix a specified number of CRSD members, there is just one court of three members, who administer justice in relation to securities cases. Considering the high importance of the first-instance court, the need for a sufficient number of judges (and courts) to ensure the effective delivery of justice is evident.\textsuperscript{933} Hence, it is argued that successful judicial enforcement requires sufficient numbers of

\textsuperscript{930} Gould v Brown (1998) 15 ACLC 316, 377 (Kirby, J); Tomasic, Bottomley and McQueen, above n 545, 76.

\textsuperscript{931} The \textit{Law of Judiciary 2007} (Saudi Arabia) Royal Decree No. M/78 (19 Ramadan 1428 H, 1 October 2007) OG Umm al-Qura No 4170 (30 Ramadan 1428 H, 12 October 2007). The \textit{Law of Judiciary} contains several sections covering various aspects of the judicial system, such as provisions securing the independence and impartiality of the courts, the types of courts and their jurisdiction, the judges, their appointment and promotions, the role of the Ministry of Justice, etc. For more details, see Ansary, above n 76.


\textsuperscript{933} See Figure 8.8.
judges and courts to deal with cases arising from the daily operation of the market. In 2010, the then Chief Justice of California (in the US) pointed to ‘the lack of available courtrooms and judges was attributable to the Legislature’s failure to provide a number of judges and courtrooms sufficient to meet the rapidly growing population’ in a particular area of that state. This failure had led to problems with the administration of justice as a number of criminal cases had to be dismissed on the basis that the defendants had not enjoyed their constitutional right to a speedy trial. Moreover, providing ‘justice for all’ is more important than the cost of operating more courts. A comparative study of efficient judicial administration has considered that the number of judges is an important element in such efficiency. The number of judges must be consistent with the number required to process the cases.

Furthermore, it can be said that having a sufficient number of judges has become imperative in a fast-growing market such as the SSE in order to handle the number of disputes arising from the market’s day-to-day operations. In addition, facilitating access to the courts is a significant factor in measuring the effectiveness of the judiciary system. Hence, ensuring the effectiveness of the enforcement of securities laws is one of the important principles of the International Organisation of Securities Commissions (‘IOSCO’). For this reason, IOSCO confirms that access to courts, or other mechanisms

935 Ibid. The right to a ‘speedy trial’ is guaranteed under the Sixth Amendment. The then CJ of California was Ronald Marc George.
937 Later, a section on the performance of the securities courts in Saudi Arabia will demonstrate the weak functioning of the current courts dealing with securities disputes.
of disputes resolution, has to be available for investors who become victims of breaches of securities laws.  

In addition, it has been observed that the CML’03 contains statutory requirements that apply to the potential members of the CRSD. In contrast, and despite the fact that the ACRSC is a higher court, there are no specific statutory qualifications required to be held by the members of this appellate court. To provide equal access to securities and facilitate claims of civil liabilities for victims of defective disclosures, it would be suggested that the number of courts and judges be increased.

8.4.2 Shortcomings in the Judicial Independence of the Securities Courts

The independence of the judiciary is the foundation of justice. It means that judges should be free to make impartial decisions based solely on fact and law without such judges being subject to any interference or influence. The delivery of justice may become difficult if judges lack independence. Handsley declares that ‘[j]udicial independence serves the rule of law by protecting judicial processes from improper influence’. With this in mind, it can be argued that the members of the securities courts in Saudi Arabia are not independent in their administration of law. This argument can be accurately based on the absence of specific provisions in the CML’03 in regard to the independence of judges of the securities courts. Although these courts are considered to have finality in their decisions and thus to be immune to any review by any judicial authority, the Saudi Arabian Basic Law of Governance 1992 (BLG’92), which declares independence of the Judiciary, does not apply to these securities

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Chapter 8: Judicial Enforcement

committees.940 In fact, the BLG’92 does not identify these courts as part of the judicial authority.941 These securities committees are established by the CML’03 which gives them the jurisdiction over all disputes arising from the securities dealings.

Equally important, judicial accountability is significant in maintaining judges’ awareness of their administration of law. ‘Accountability’ refers to the obligation of public officials to explain, justify and legitimise the use of power in discharging public duties.942 Akkas notes that the accountability of judges may be ensured in a number of ways: public exposure of judicial functions (including public reporting of decisions); reasons being supplied for judicial decisions; appellate process; discipline of judges; and scrutiny by lawyers.943 There are no such provisions in the CML’03 that relate to the members of the securities courts in Saudi Arabia. Judicial accountability has a considerable impact on the balance between judicial independence and impartial justice. In this respect, Shetreet strongly argues that ‘[j]udicial independence cannot be maintained without judicial accountability for failure, errors or misconduct’.944 Moreover, White points out that ‘[a] judge remains accountable to the fair application of the law regardless of the judge's endorsement of or belief in the law’.945 However, it is beyond the scope of this thesis to discuss possible ways of ensuring judicial accountability that can be applied to the members of securities courts in Saudi Arabia.

941 Basic Law of Governance 1992 (Saudi Arabia) art 49 and 53 only confirm the existence of the Shari'ah courts and the Board of Grievance.
945 Penny J White, above n 921, 1060.
On the other hand, the LJ’07 aims to provide judicial independence and to ensure protection for the judges in general courts. In contrast to the requirements that exist for judicial independence in the general courts, the requirements for members of securities courts do not require the members be independent, nor to not take any other jobs in the government or in the private sector. In fact, the current situation is that the members of the securities courts in Saudi Arabia hold the position of judge, as well as engaging in other employment and activities in both the government and private sector. This situation clearly is at odds with perceptions of judicial independence from government or private interest. The concept of judicial independence requires that judges should not be subject to control by the political branches of government and that they should enjoy protection from any threats, interference, or manipulation which may affect them to unjustly favour party against another. Nor should there be any possible perception of that they might be subject to such control or influence. This can also be said in regard to any relation to the private sector (for example, acting as an advisor or engaging in any employment).

The principles of judicial ethics require that a judge be a full-time salaried position and not to receive money from any other form of employment. Moreover, a study on judicial ethics affirmed the principle of judge’s independence by stating that ‘unlike the legal practitioner, the judge must be independent of governments, institutions and

946 Law of Judiciary 2007 (Saudi Arabia) art 1 provides that ‘Judges are independent and, in the administration of justice, they shall be subject to no authority other than the provisions of Shari‘ah and laws in force.’; see also Bin Shalhoob, above 74, 374.
947 According to art 51 of the Law of Judiciary 2007 (Saudi Arabia), ‘a person may not hold the position of a judge and simultaneously engage in commerce or in any position or work which is not consistent with the independence and dignity of the judiciary’.
949 There are few exceptions: for example, judges can receive a fee or royalties earned as an author or editor. See Judiciary of Scotland, ‘Statement of Principles of Judicial Ethics for the Scottish Judiciary’ (April 2010) <http://www.scotland-judiciary.org.uk/Upload/Documents/Principles.pdf>.
individuals and must be impartial in the discharge of his or her adjudicative responsibilities'.

A further issue is that although LJ’07 sets down the requirements for the appointment of judges at all court levels, these requirements do not apply to the members of the securities courts in Saudi Arabia. More importantly, there is no statutory protection for the members of courts in their administration of law in the CML’03, which works against the principle of judicial independence. The necessary protection should be given to the members of the securities courts, as these protections are already afforded to judges of the general courts in Saudi Arabia. Therefore, the negative impact on judges of not having sufficient protection can be also reflected on litigants who are looking for a fair and quick trial. For that reason, Williams declared that ‘[adequate] constitutional protection must be afforded judicial office and adequate remuneration, as [t]hese protections allow judges to deal with all cases that come before them without having to worry about the security of their office, or having their pay reduced, if decisions unfavourable to the government are made’.

In contrast, the judiciary in Saudi Arabia aims for judicial independence, providing sufficient guarantees for the judges and their functions, which allow judges (other than those in the securities court) to carry out justice ‘without fear or favour’, that is, without the threat of outside intervention or influence or the offer of inducements. As Ferejohn points out, ‘[I]nstitutional judicial independence is, however, a complex value in that it really cannot be seen as something valuable in itself; … [r]ather, it is instrumental to the

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951 Larkins, above n 948, 608.
952 Daryl Williams, 'Judicial Independence and the High Court' (1998) 27 University of Western Australia Law Review 140, 150.
pursuit of other values, such as the rule of law or constitutional values’. Therefore, the LJ’07 provides a number of judicial protections for judges, such as: protection from dismissal, protection from administrative controls and bias, and judicial immunity. In all cases, the Supreme Judicial Council has complete power over the protections afforded to judges. This is a marked advance on the previous provisions, yet these provisions still do not apply to members of the CRSD or the ACRSC.

Consequently, it can be clearly said that the current judicial system for the settlement of securities disputes has shortcomings in relation to the independence and effectiveness of the judges and courts in Saudi Arabia. The above discussion has clearly shown that despite the need for members of the CRSD and ACRSC to be independent in their administration of justice, no provision has been made in law that would match the provisions for judges in other courts.

8.4.3 Need for Efficient Judges in the Securities Courts

Having independent and sufficient courts is not enough for proper judicial enforcement. In fact, providing justice under any law requires a clear understanding of that law. In respect of the securities literature, which is highly complex and technical, advanced knowledge of law and proper training are imperative. Therefore, adequate training, experience and knowledge is essential for proper adjudication of contraventions of securities laws.

953 Ferejohn, above n 898, 353.
954 The Law of Judiciary 2007 (Saudi Arabia) arts 2 and 3.
955 Ibid art 57.
956 Ibid art 4.
957 The Supreme Judicial Council is the highest authority in the current judicial system in Saudi Arabia. For more details about the composition, jurisdictions and powers of the Supreme Judicial Council, see arts 5, 6, 7 and 8 of the Law of Judiciary 2007 (Saudi Arabia); Ansary, above n 76.
The earlier description of the members of the securities courts shows that the court of first instance, the CRSD, will consist of ‘legal advisors specialised in the doctrine of transactions and capital markets, and experts in commercial and financial affairs and Securities’.\footnote{Capital Market Law 2003 (Saudi Arabia) art 25(b).} On the other hand, the ACRSC (the appellate securities court, which is the highest securities court) does not specify either specific requirements or qualifications for its members.\footnote{Ibid art 25(g).} This is despite the fact that the ACRSC is empowered to affirm or refute the lower court’s finding, or refuse to review the case (based on the record at the hearing before the CRSD), and to issue a decision that is considered final.\footnote{Ibid.}

In a democracy, the judiciary has the responsibility to uphold the legislation and, where it may appear unclear (perhaps in a new or different situation), interpret it by determining the intention of the legislator. Interpretation is required to ensure whether the act in question constitutes a violation of the law in question. The judiciary has a duty to deliver justice to the litigants in terms of the legislation before it and may call upon precedents to assist in the decision-making.\footnote{Ibid.} Efficient courts are required to provide the correct interpretation of the law and a fair trial for the litigants.

Weak judicial enforcement can be a considerable obstacle to the functioning of securities laws and ‘can hobble the enforcement of corporate law in emerging

\footnote{In general judges have several duties. Some of the most important of them are:  
\hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} i. \hspace{1cm} to ensure that the rules of evidence are followed;  
\hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} ii. \hspace{1cm} to ensure that each party is fairly treated according to the law;  
\hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} iii. \hspace{1cm} to sum up the arguments impartially, and explain to the law regarding the particular action;  
\hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} iv. \hspace{1cm} to ensure that the burden of proof has been discharged;  
\hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} v. \hspace{1cm} in a civil case, to assess damages;  
\hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} \hspace{1cm} vi. \hspace{1cm} to hear appeals.  
For more details, see Andy Gibson and Douglas Fraser, Business Law (Pearson, 4th ed, 2009) 60.}
Chapter 8: Judicial Enforcement

markets’. For that reason, it is said that ‘[i]f a judge lacks adequate knowledge, efficiency, integrity and honesty, it may result in miscarriage of justice’. It can also result in parties not being treated fairly in accordance with the law and the handing down of decisions which are not of relevance to the matters before the court.

In the case of Saudi Arabia, the lack of experienced and well-trained judges may undermine the enforcement of securities laws. For instance, a judge may be mistaken in his interpretation of the law, which in turn may lead to unclear rulings that vaguely identify the persons who are liable for the contravention in question. Such a vague case law decision can advantage the defendants. Moreover, an unclear understanding of a law may lead to a wrong judgment or the inappropriate imposition of the lowest or maximum penalty allowed by the law. In addition, an inefficient judge may cause a delay in the delivery of justice as he struggles with the complexity of the law and the matter before him.

Taking into the consideration the above implications of ineffective judges in the fair administration of justice, it can be said that well-trained, efficient judges are needed for a successful investor protection regime in the securities market.

The nature of securities disputes requires a professional and specialised body which performs efficiently and expeditiously. It is always argued that a specialised court is ideal for the enforcement of securities law because experienced and trained judges are important for the purpose of effective judicial enforcement.

Chapter 8: Judicial Enforcement

Fair administration of justice is the key to a successful judiciary. Education and training are two requirements that are essential for achieving efficiency in any profession. In addition, potential judges who have prior legal practice experience can be more efficient than those who have not. In Saudi Arabia, holding a formal legal qualification is not compulsory for a person willing to be appointed as a member of the higher securities court (the ACRSC) yet this body has the power to impose a penalty of imprisonment for up to five years.966

Not only do members of the ACRSC lack a law degree, neither are they required to have the proper training for and experience of being a judge. It is agreed that professional background is an important element in the appointment of judges. A recent US study found that 64 per cent of all justices appointed to the Supreme Court of the United States had a variety of prior experiences, such as, as attorneys in private practice and as judges in lower courts.967 Moreover, the study showed that experience in private practice, judicial experience and educational backgrounds are viewed as significant in terms of requirements for those to be appointed judges of the Supreme Court.968 Another study found out that ‘a quality education and extensive prior legal and judicial experience are reasonable indicators of likely judicial expertise and potential for quality judicial work’.969

966 The CRSD issued a final decision of a three-month term of imprisonment against the chairman of the board of directors of Bishah Company. The imprisonment was as result of insider trading violation. See Abdullah Albsalei, 'The First Decision of Its Kind: Imprisonment of the Chairman of Bishah', Aleqtisadiah (online), 19 August 2009 <http://www.aleqt.com/2009/08/19/article_264390.html> [Arabic].
968 Ibid 12.
Judges who have a legal background coupled with sufficient experience are also more able to avoid delay in the delivery of justice. Shleifer points out that ‘[i]n some areas, even with expert advice, it might take a judge an enormous effort to understand liability and damages’. 970 Tomasic concludes with the view that the judges need to be experienced in the adjudication of complex securities cases in a timely way. 971 This reveals the necessity for sophisticated judges to deal with cases of securities issues. Thus, the presence of qualified judges is imperative in ensuring the effectiveness of the enforcement of securities laws. In this regard, Black calls for ‘[a] judicial system that: (a) is honest; (b) is sophisticated enough to understand complex self-dealing transactions; (c) can intervene quickly when needed to prevent asset stripping; and (d) produces decisions without intolerable delay’. 972 This shows the importance of having qualified judges to deal with the difficulty and complexity of securities laws.

Based on the above, it can be said that efficient judges for adjudication of securities litigations are of paramount importance if there is going to be a successful judicial enforcement of securities laws. Judges with training for and experience on the bench, coupled with relevant legal education and prior legal practice, are needed to ensure proper and fair judgements in securities disputes. In Saudi Arabia, the inadequate performance of the securities court implies that the judges lack practical experience in dealing with cases involving disclosure allegations. 973 Additionally, the appointment of members needs to be in accordance with certain designated criteria. The absence of such criteria becomes more evident in the case of the appellate court. However, the judiciary

973 Section 8.5 provides an evaluation of the current performance of the securities courts in Saudi Arabia.
in Saudi Arabia is not only short of efficient judges but also the experienced lawyers necessary for the efficient enforcement of securities laws.

8.4.4 Lack of Lawyers Skilled in Dealing with Securities Litigation

Lawyers have an essential role to play in the judicial system. Efficient lawyers are an important part of the enforcement process of securities laws. Thus, there is a need for experienced and trained lawyers as they are important for successful judicial enforcement. In Saudi Arabia, the lack of case law regarding defective disclosures reveals that the enforcement of securities laws and related court and legal practice is a relatively new or unusual phenomenon for the courts and, therefore, for lawyers. As a result, it is to be expected that lawyers in Saudi Arabia would be lacking in critical knowledge regarding securities laws. Currently, no universities in Saudi Arabia offer a formal degree or diploma program in the field of securities regulation. Neither do any law schools in the country provide teaching or training in securities law to any appreciable extent. The business and economics colleges merely teach securities markets as a part of a subject in their curricula, but they teach it from business and economics perspectives.

Law schools in Saudi Arabia teach the subject ‘Company Law’ without any particular focus on its significance in respect to the securities markets. Besides, despite its being taught as a single subject as part of a law degree majoring in commercial law, the subject does not deal with the securities laws or instruct students in regard to the provisions of the CML’03. In addition, the subject as taught does not deal in particular with civil liabilities arising from the violation of the disclosure requirements. Therefore,

Chapter 8: Judicial Enforcement

law graduates have a serious lack of knowledge about securities markets and their regulation. The lack of a degree with particular focus on securities laws and relevant knowledge may be discouraging those who would otherwise consider undertaking higher degree programs in the field of securities regulation. Accordingly, carrying out in-depth research in securities laws may be impeded. The lack of such training is also an impediment to the development of the market and the protection of investors as those lawyers who be called upon to act as legal advisors to companies may not be equipped with the requisite knowledge to best undertake their role in relation to the issuance of a prospectus, periodic reports and the like, or to be able to guide company directors and executive officers and others in their responsibilities regarding disclosures (which have been touched upon earlier).

In Saudi Arabia, despite the fact that the Code of Law Practice 2001 (CLP’01) exists to govern the profession of legal practice and representation, there is no bar council for legal practitioners. In fact, there is no single statutory body for the regulation of the legal profession in the country. The Ministry of Justice administers the legal profession, which is contrary to the fostering of independence of the profession.

As of August 2011, there are 1611 lawyers registered in the records of practising lawyers in the Ministry of Justice. This number of lawyers is relatively small compared to the country’s population of 27 million. The lack of lawyers, together with the absence of an independent bar council, may have a negative impact on the legal

975 Royal Decree No. (M/38) 28 Rajab 1422 [15 October 2001].
977 The population of the Kingdom of Saudi Arabia is 27,136,977, including a significant number of non-Saudies (about 9 million), according to the 2010 census. See Gulf in the Media, 'Saudi Arabia Announces Preliminary Results of Census' (5 August 2010) <http://www.gulfinthemedia.com/index.php?m=gcc_press&id=2267507&cnt=171&lang=en&PHPSESSID=>.
profession in Saudi Arabia. Several experts in the legal profession in Saudi Arabia confirm that the lack of lawyers may delay the delivery of justice, as well as impair plaintiff’s rights.978

In light of the current situation in Saudi Arabia, there are several factors undermining legal practice in the country. Some of the most important of them are mentioned below:

i. Law schools are not attractive to students, which has led to a shortage of lawyers and law degree holders;
ii. Bar associations are absent;
iii. No proper protections are provided to lawyers, neither by the law maker or the government;
iv. There is an absence of legal training programs to ensure lawyers are qualified to practise law efficiently;
v. A low fee structure in comparison with neighbouring countries acts as a disincentive.979

Furthermore, the need for a constructive role for lawyers becomes more evident in relation to the interpretation of laws. Because of the complexity of court operations and securities cases, courts may rely on the exploration of laws by lawyers who could be paid for discharging their professional responsibilities in such a manner, especially in light of the lack of formal training and experience being required of judges in securities

978 The experts identified that the country is currently in need of 10,000 lawyers. For more details, see Syrian Website for Legal Studies, 'Lack of Lawyers Delays Cases and Harm Plaintiffs’ Rights' (27 March 2011) <http://www.barasy.com/news-print-6369.html> [Arabic].
979 In comparison with the neighbouring gulf countries, Saudi Arabia comes third after the United Arab Emirates and Kuwait in regard to the highest fees commanded by lawyers. See Iman Alkhataf, 'Lawyers: We Are Not Greedy and the Saudi Lawyers' Income Ranked Third after the United Arab Emirates and Kuwait', Asharq Al-Awsat (online), 28 October 2007 <http://www.aawsat.com/details.asp?section=43&article=443218&issueno=10561> [Arabic].
Chapter 8: Judicial Enforcement

matters, especially in the appellate court. In this regard, Shleifer points out that ‘[w]hen issues are complex, courts rely on experts to interpret contracts and testify as to appropriate precautions, remedies, and damages.’\textsuperscript{980} It is submitted that appropriately trained and experienced lawyers could fulfil that role. In this respect the universities might reconsider their course structure and content to ensure an even better class of graduate, and offer improved post-graduate training to better fit them for tasks they may encounter as corporate lawyers in the commercial sector or in the court sector itself, particularly in relation to the CRSD and ACRSC. Lawyers need to be experienced and trained to deal with complicated cases and to seek judicial favour (in terms of outcomes for clients or as associates to judges) not simply enlightenment.\textsuperscript{981}

Lawyers are actively involved in the judicial system and judges are in need of efficient lawyers to assist them in their administration of justice. Hence, it can be reiterated that experienced and trained lawyers can play an important role in the enforcement of securities laws.

In Saudi Arabia, the above discussion shows that drawbacks continue to persist in respect of the legal profession and legal practice. In particular, the lack of experienced and trained lawyers is unfavourable in regard to the effective judicial enforcement of securities laws.

Consequently, it can be said that the lack of laws governing the securities courts and their members is undermining the fair judicial enforcement of securities laws in Saudi Arabia. Hence, arguably these weaknesses have an adverse impact on investor protection.

\textsuperscript{980} Shleifer, above n 970.
\textsuperscript{981} Ibid 12.
8. 5 Evaluation of the Current Performance of the Securities Courts in Saudi Arabia

Successful enforcement requires an efficient judiciary to deal with contraventions of securities laws. In fact, courts perform important public functions and therefore the quality of their work is fundamental for the delivery of justice. Thus, it is necessary to evaluate the effectiveness of the current securities courts in Saudi Arabia. The measurement of the performance of the securities courts is crucial to finding out whether the current courts are operating efficiently or not.

Although there are special courts for securities market disputes in Saudi Arabia, there is a need for judicial reforms in order to have effective enforcement of the securities laws. This recommendation is based on the weak performance of the securities courts in Saudi Arabia. Despite the need that the first instance court has to be more effective in dealing with cases and in delivering justice within a reasonable time, the performance of the CRSD is weak in practice.

Article 25(b) the CML’03 states that ‘[t]he Committee must start considering the complaint or the suit within a period not to exceed fourteen days from the date of filing of the complaint or the suit with the Committee’. Nevertheless, the CRSD takes far longer than the time stipulated to make a judgment on a case. From the CRSD’s commencement in December 2004 until 2011, its performance has been criticised. According the chart below, in 2005 and 2006, the level of functioning of the court was reasonably high; however, the function of the CRSD decreased significantly thereafter.
Chapter 8: Judicial Enforcement

Figure 8.8: Number of Cases Filed with the CRSD and Finalised in the Year they were Lodged.

![Bar chart showing the number of cases filed and finalised in the year they were lodged from 2005 to 2011.

Source: Capital Market Authority

According to the annual reports released by the CMA, there were just 38 civil suits finalised out of the 211 civil suits filed during 2009 and 2010. These figures demonstrate the weak performance of the CRSD. In addition, the performance of the ACRSC is no better than that of the CRSD. For example, there were 75 decisions issued out of 187 appealed cases in 2009.

Accordingly, it can be reasonably argued that although the law stipulates a fixed period for the disposal of a case commenced before the CRSD, the number of resolved cases is very low when compared with the number of cases lodged within the

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982 Capital Market Authority, ‘Annual Report of 2010’, above n 750, 137. In addition, the number of cases filed in 2008 was 175 cases, within 39 cases were finalised within the year they were lodged. See Capital Market Authority, ‘Publication and Reports: Annual Report of 2009’, above n 341, 145.


984 Capital Market Law 2003 (Saudi Arabia) art 25(b) states that ‘The members of the Committee shall be appointed by a Board decision for a three-year term renewable’.
same period. These facts lead to questions about the efficiency of the CRSD, which is the court of first instance and supposed to be active and effective in dispensing decisions in regard to securities disputes. In addition, this may reflect that the case management by a judge may be poor in respect of both prioritising and resolving the cases. Moreover, it is not clear if although there are only three judges, whether they sit individually and not as a panel.

The delay in the disposal of cases has a negative impact on the litigants as well as on public confidence in the judiciary. The wrongdoers may also double their gains from the violation that they committed in the interim; while, on the other hand, the plaintiff may become ever more desperate to obtain compensation for their loss or damage resulting from the violation. In addition, public confidence in the judiciary decreases, as is evident from the lack of people’s desire to bring an action to the court.

As noted above, the judiciary dealing with securities cases requires improvements in order to provide justice to all litigants. It is important that the delivery of judgments be both speedy and cost-effective — these are two important elements of an efficient judiciary. Thus, the blame substantially rests with the courts, which have the responsibility to apply the applicable laws, and involve matters such as court funding, provision of adequate training of personnel and so forth. For that reason, Pistor comments that the effectiveness of any good law depends mainly on the efficacy of its enforcement institutions.  

With this in mind, it can be said that the current judiciary for the adjudication of securities cases requires significant improvements to deal effectively with the cases.

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lodged and avoid delay in delivering judgments. This can be done by increasing the
number of judges and by imparting appropriate training to them. Having one first-
instance court with just three judges to deal with all cases arising from the securities
market is regarded as a big obstacle to the effectiveness of judicial enforcement. On the
other hand, judges also need to be properly trained in order to improve their efficiency.

The existence of rules, criteria and methodology for ascertaining the quality and
performance of judges is crucial to bringing about improvement in the judiciary in
whole.\(^{986}\) In Saudi Arabia, assessments of the current securities courts and judges are
yet to be determined. The lack of sufficient and accurate information on the
performance of the securities courts can make the assessment issue difficult. But it is
crucial, for — as a comparative study on the efficiency in judicial administration
concludes — ‘information on the court performance can assist in promoting greater
confidence in the rule of law as well as the economy’.\(^{987}\)

Similarly, Jackson and Roe state that ‘[i]t would, moreover, be useful to collect
information on the actual enforcement activities undertaken in each jurisdiction: how
many cases prosecuted per year; how many sanctions imposed and with what level of
monetary penalty’.\(^{988}\)

In addition, the public have no knowledge with respect to the criteria that is used to
select the members of the securities courts, nor on what basis or qualifications they have
been chosen. Mahony pointed out that in order to maintain accountability of the

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\(^{986}\) Penny J White, above n 921, 1068. In the US, in addition to the *Code of Conduct for United States
to enhance judicial performance. For more details, see United States Courts, ‘Code of Conduct for United

\(^{987}\) Dakolias, above n 936.

\(^{988}\) Jackson and Roe, above n 675, 237.
judiciary, the public must be involved in evaluating judicial performance.\textsuperscript{989} Hence, public scrutiny is recommended to enhance judicial enforcement.\textsuperscript{990}

On the basis of the above, it can be clearly said that the judicial enforcement of securities laws in Saudi Arabia is weak. It has been demonstrated that the performance and effectiveness of the securities courts in Saudi Arabia is poor. Thus, the current state of the enforcement of securities laws is unfavourable to investor protection in the Saudi securities market.

**8. 6 Suits Brought by the Securities Regulators on Behalf of Investors**

The CMA is entitled to lodge civil suits on behalf of investors who have suffered loss or damage as a result of the violation of the provisions of the CML’03 and the rules of the CMA and the Saudi Stock Exchange (SSE).\textsuperscript{991} The CMA has expanded its powers to seek recoveries on behalf of investors. In this regard, art 59(a) of the CML’03 provides that:

> If it appears to the Authority that any person has engaged, is engaging, or is about to engage in acts or practices constituting a violation of any provisions of this Law, or the regulations or rules issued by the Authority, or the regulations of the Exchange, the Authority shall have the right to bring a legal action before the Committee to seek an order for the appropriate sanction. The sanctions include the following:

1. Warning the person concerned.
2. Obliging the person concerned to cease or refrain from carrying out the act which is the subject of the suit.
3. Obliging the person concerned to take the necessary steps to avert the violation, or to take such necessary corrective steps to address the results of the violation.


\textsuperscript{991} These provisions certainly include disclosure requirements and rules provided under the \textit{Capital Market Law of 2003} (Saudi Arabia) and the Capital Market Authority regulations and rules.
Chapter 8: Judicial Enforcement

4. Indemnifying the persons who have suffered damages as a consequence of a violation that has occurred, or obliging the violator to pay to the Authority’s account the gains realized as a consequence of such violation.

5. Suspending the trading in the Security.

6. Barring the violating person from acting as a broker, portfolio manager or investment adviser for such period of time as is necessary for the safety of the market and the protection of investors.

7. Seizing and executing on property.

8. Travel ban.

9. Barring from working with companies whose Securities are traded on the Exchange.

Article 59 of the CML’03 resembles § 21(d)(1) of the Securities Exchange Act 1934 (US) (SEA’34), but with less specificity.992 In this situation, the CMA may seek a court order against the violator. The CMA carries the burden of proof in every case on behalf the public. The CRSD is empowered to impose a wide variety of sanctions/remedies.993 Moreover, art 59(b) of the CML’03 states that, upon a request from the CMA, the CRSD has the power to impose a fine against any person responsible for knowingly violating the law or any rule.994 It should be noted that s 128 of the Securities Act of 1990 (Ontario) (SA’90) provides similar court remedies to those of the CML’03.995

992 Securities Exchange Act 1934 (US) § 21(d)(1) provides:
Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this title, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association …. it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States … to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this title or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title.

993 The terms ‘sanction’ and remedy’ will be interchangeably used to indicate the court’s potential decisions as specified under art 59 of the Capital Market Law 2003 (Saudi Arabia).

994 Ibid art 59(b).

995 Section 128(1) of the Securities Act 1990 (Ontario) provides: ‘The Commission may apply to the Superior Court of Justice for a declaration that a person or company has not complied with or is not complying with Ontario securities law’. Thus, the court is empowered to impose variety of remedies against the violator. See also s 128(3), which authorises the court, at the request of the Commission to ‘make any order that the court considers appropriate against the person or company’.
However, under art 59 of the CML’03, it can be clearly seen that the CRSD has the power to enforce the securities laws by way of a variety of statutory remedies against wrongdoers. Moreover, art 59 encompasses both types of remedies: legal and equitable which are discussed in the next section. The CMA has the power to take action to the court to seek an order for appropriate sanctions against the violators. The above article is to be applied to any contraventions within the provisions of the CML’03 and the regulation and rules of the CMA and the SSE.

8.6.1 An Outline of the Current Securities Court’s Remedial Powers Provisions

The CRSD can make orders on the following: compensation, monetary fine, injunction, specific performance/rectification, account of profit, trading suspension, barring the violator from acting as a broker, seizing property, imposing a travel ban and barring the broker from working with companies whose securities are traded on the Exchange.

Under art 59 of the CML’03, remedial powers of the court are available. The court has the jurisdiction to deal with the civil suits brought by the securities regulators on behalf of investors. The following section highlights the court remedies against the violators of the law, rules and regulation of the securities market. In order to do so, the court’s potential remedies will be divided to two categories; legal remedies and equitable remedies.

8.6.1.1 The Legal Remedies

The legal remedies available under the CML’03 are the compensation order and monetary fine.

8.6.1.1.1 A Compensation Order
Article 59(a)(4) of the CML ‘03 allows the court to order the violator to ‘[i]ndemnify the persons who have suffered damages as a consequence of a violation that has occurred’. This remedy aims to recover investors’ losses and damages resulting from a violation of the securities laws and regulations. Therefore, this provision can be applied in instances of contraventions of the disclosure regime. The compensation is ordered by the CRSD after being initially requested by the CMA. The CRSD can subsequently impose a compensation order on the wrongdoer.

However, it has not been customary for such cases to be brought by the CMA on behalf of the investors who have sustained loss or damage due to violation of disclosure requirements. Despite the CMA having the power to sue the violator in order to obtain compensation for aggrieved investors, the use of this power is almost non-existent. The above provision is unclear regarding the recompense of injured investors. The CMA has a significant role to play, as the CMA is required to protect the investors, to uncover any violations of the law and to specify the investors who have been victims. The remedy of a compensation order needs further interpretation in order to strengthen the civil liability regime, foster confidence among investors and clarify the role of the CMA powers to sue wrongdoers.

8.6.1.1.2 A Monetary Fine

In addition to this, in art 59 (b), the CMA can request the imposition of a monetary fine against liable persons appearing before the CRSD. The CRSD has the power to levy a fine of between SAR 10,000 and SAR 100,000 (between USD 2,666 and USD 26,660) against any person liable for knowingly violating the law or any associated rule.
The CMA may request that the CRSD fine the violators. For instance, in a case brought by the CMA against a violator who manipulated other investors to buy shares in a certain company, the CRSD imposed a fine of SAR 100,000.\textsuperscript{996} The remedy of a monetary fine is only issued by the CRSD as an additional sanction for those who have deliberately violated the law of its rules, and imposes it as an extra deterrent for those who may consider doing such activities. However, many market participants have recently raised questions regarding the fines issued by the CRSD.\textsuperscript{997} While the CRSD requires the accused person to pay the fines to the CMA’s account, the harmed investors will receive no compensation.

8.6.1.2 Equitable Remedies

Generally, in common law countries equitable remedies are more frequently granted than legal remedies.\textsuperscript{998} According to paras 1–9 of art 59(a) of the CML’03, there are several equitable remedies available for the court in regard to the violators. They are: injunction, specific performance, rectification, account of profit, trading suspension, barring the violator from acting as a broker, seizing property, imposition of a travel ban and barring the broker from working with companies whose securities are traded on the SSE.

The first is an \textit{injunction}.\textsuperscript{999} The CMA can seek an injunction before the CRSD for imposition on persons who have violated the CML’03 or the CMA regulations and

\textsuperscript{996} CRSD Decision No 9/L/D1/2006 of 1426 H Issued 1 January 2006. In addition, the CRSD barred him from trading in the securities market for three years.


\textsuperscript{998} David Wright, Remedies, above n 684, 3.

\textsuperscript{999} Commonly injunctions are defined as a court order (exercising the equitable jurisdiction), which restrains the defendant from carrying out, or commands the defendant to perform, a specific act. See Cossins, above n 683, 631.
rules. The CRSD has the power to warn the person who is the subject of the disclosure violations. In addition, an injunction can become a court order to prevent the perpetrator of the violation from continuing the act in question. Despite the Saudi law being direct here, there are not sufficient details about the injunction criteria.

Although the CML’03 stipulates that the exclusive jurisdiction to grant injunctions is with the CRSD, the CMA has also exercised this remedy.\textsuperscript{1000} This contradiction in the role of the CMA is considered as a weakness of this remedy. It arises from the principle that injunctions are always granted at the discretion of the courts.\textsuperscript{1001}

The second court remedy is specific performance.\textsuperscript{1002} The CRSD has the power to order a specific performance by persons in order to avoid their committing a violation.\textsuperscript{1003} Article 59(a)(3) of the CML’03 states that specific performance involves ‘[o]bliging the person concerned to take the necessary steps to avert the violation’. According to this provision, the specific performance remedy is an obligation placed on the person in order to avoid committing a violation. The serious dearth of cases concerning the remedy of specific performance deserves a further investigation; however, it is beyond the scope of this thesis.

The third court remedy is rectification. This remedy differs from the specific performance remedy, the major difference being that a rectification remedy always

\textsuperscript{1000} The Capital Market Authority (Saudi Arabia) warned Tihama Advertising & Public Relations; this warning was about breaching art 26 of Listing Rules 2004 (Saudi Arabia). The breach was that it did not adhere to annual financial statement requirements for fiscal year ended 31 March 2005. For details, see also Beach, above n 24, 351.

\textsuperscript{1001} Covell and Lupton, above n 683, 229.

\textsuperscript{1002} Capital Market Law 2003 (Saudi Arabia) art 59(a)(3). IS IT 58(a)(3) see intro re remedies under 58(a)

\textsuperscript{1003} In UK and Australian law, specific performance is a discretionary equitable remedy, by which the court compels a party to perform its contractual obligations according to the agreed terms. See Yuen-Yee Cho and Victoria Todd, 'Beware Specific Performance' (2008) 27 International Financial Law Review 36, 37.
comes after a violation has been committed and addresses the results of a violation. According to art 59(a)(3) of the CML’03, rectification ‘obliging the person concerned to take such necessary corrective steps to address the results of the violation’. Conversely, specific performance remedy comes before the commission of a, perhaps further, violation, and thus requires certain acts to avoid a violation and the results that might otherwise attend it.

The fourth court remedial power is the account of profit. This can be brought by the CMA on behalf of investors.\textsuperscript{1004} This remedy is found in art 59(a)(4) of the CML’03 where the violator may be obliged ‘to pay the CMA the gains realised as the result the violation’. Therefore, the account of profit is available against persons who have made a profit based on a violation of the provisions of CML’03 and the CMA rules and regulations. This remedy has been imposed by the CRSD in several cases, none of which concerned defective disclosures in a prospectus, or in continuous disclosure and periodic disclosures. The available cases are mostly associated with the violations concerning insider trading, which is beyond the scope of this thesis.\textsuperscript{1005}

The major weakness of this remedy in CML’03 that should be mentioned is that the sole plaintiff permitted is the CMA. As stated in art 59(a)(4), the CMA alone is allowed to seek the remedy of ‘account of profit’ before the court. The practice in Saudi Arabia differs to that in a number of common law countries in this regard, for while an account

\textsuperscript{1004} It is argued that ‘account of profit’ is quite similar to ‘restitution remedy’. This is because they are both considered to be monetary remedies. In fact, restitution differs from account of profit remedy. Also known as a ‘restitutionary damages remedy’, this phrase would be widely used to describe all monetary remedies including damages. See Peter Birks, \textit{Restitution – The Future} (Federation Press, 1992) 16–25.

\textsuperscript{1005} For example, the CRSD required the accused person to pay to the CMA’s account the gains that resulted from violation acts amounting to SAR. 16,837,224 (USD 4.5 million); See Committee for the Resolution of Securities Disputes, CRSD Final Decision Case No 15/27, CRSD Decision No 43/L/D1/2006 of 1427 H (issued 03/08/1427 H (01/09/2006 G).Committee for the Resolution of Securities Disputes, Issued Decisions (11 December 2012) <http://www.crsd.org.sa/En/Disputes/27-43%20E.pdf>.
of profit is about taking away the gain, victims must be able to be recompensed for the loss and damages they suffer as a result of that illegal gain.\textsuperscript{1006} For that reason, it has been affirmed in Australia that account of profit is not there available in tort unless exemplary damages are available.\textsuperscript{1007} To the contrary, however, Wright claims that the focus of this remedy is the defendant’s gain, not plaintiff’s loss.\textsuperscript{1008} Nevertheless, individuals must have the right to prevent violators from retaining gains made, based on a breach of the market laws, and the victims of such breaches should have the right to claim their loss after the gain is paid to the CMA’s account.\textsuperscript{1009} McGlone and Stickley confirm that in business transactions, the remedy of account of profit is significantly useful.\textsuperscript{1010} The situation in Saudi Arabia, however, requires a clear mechanism to distribute the gains resulting from the law violations to all investors who sustain loss or damage as a result of that violation, rather than simply allowing them to accrue in the accounts of the CMA for its use. Indemnification of injured investors will increase investor confidence in the securities market by fostering the protection of investors.

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\textsuperscript{1007} \textit{Hospitality Group Pty Ltd v Australian Rugby Union Ltd} (2001) FCR 187, 197 (Hill and Finkelstein JJ).

\textsuperscript{1008} David Wright, \textit{Remedies}, above n 684, 103. In addition, the distinction between an account of profit and damages is that the defendant is obliged to merely repay the gain resulting from the wrongdoing. See \textit{Colbeam Palmer Ltd v Stock Affiliates Pty Ltd} (1968) 122 CLR 25, 34-8.

\textsuperscript{1009} For example, a decision of the CRSD against the violator to pay the CMA’s account the sum of SAR 91 million (USD 24,266,666), which resulted from the breaches of the securities regulations. Many investors claimed loss and damages from several breaches of the law by the violators, and they disagreed with the decision that the gains of the violators go to the CMA’s account. See Khalid Alawaid, ‘The CRSD Obliges Alqhtani to Return His Gains in Share Market to the CMA’s Account Because of the Violation of Regulations’, \textit{Alriyadh} (online), 14 December 2006 <http://www.alriyadh.com/2006/12/14/article208887.html> [Arabic].

\textsuperscript{1010} Frances McGlone and Amanda Stickley, \textit{Australian Torts Law} (LexisNexis Butterworths, 2\textsuperscript{nd} ed, 2009) 331.
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It can be seen that the law has given the CRSD the option to impose compensation or to oblige the defendant to return profits resulting from this violation to the CMA.\textsuperscript{1011} In practice, as can be seen from the discussion above, it has failed to impose the former and instead favours the latter practice. This can be unfair for the victim/plaintiff and may result in no compensation. The situation in Australia is substantially different under the Australian Securities and Investment Commission (ASIC). The regulator has given compensation a priority over other remedies in order to remedy plaintiffs’ loss or damage. It states that ‘preference must be given to compensation for victims’.\textsuperscript{1012}

The fifth court remedy is \textit{trading suspension}. The CRSD, upon a request from the CMA,\textsuperscript{1013} can suspend the trading of a company’s securities on the SEE when it appears that this company is in violation of the law. Additionally, trading suspension may extend to any person who violates the law from trading in the securities market.\textsuperscript{1014} However, this remedy is inadequately presented in Saudi securities law. It lacks details about the mechanism of this temporary suspension of a security. Moreover, it does not specify who can be subject to this sanction, nor the period of suspension.\textsuperscript{1015} A security can also be subject to trading suspension, and there is overlapping between the CMA

\textsuperscript{1011} In order to analyse this remedy, it is important to mention the whole paragraph of art 59 (a)(4) of the CML’03: ‘compensate persons who suffered damage or loss as a result of the violation committed /or oblige the violator to pay the CMA the gains realised as a result of the violation’. The use of conjunction ‘or’ indicates that the two (compensation to those who suffered loss or payment of gains realised to the CMA) are alternatives; and the body that makes the decision as to which to impose is the CMA.

\textsuperscript{1012} \textit{Australian Securities and Investments Commission Act Amendment (No 51) 2001} (Cth); see s 12GCA. The conditions of compensation preference are: If: (a) the Court considers that it is appropriate to impose a fine under section 12GB in respect of a contravention, or an involvement in a contravention, of this Division; and (b) it is appropriate to order the defendant to pay compensation to a person who has suffered loss or damage in respect of the contravention or the involvement; and (c) the defendant does not have sufficient financial resources to pay both the pecuniary penalty or fine and the compensation; the Court must give preference to making an order for compensation.

\textsuperscript{1013} \textit{Capital Market Law 2003} (Saudi Arabia) art 59(a)(5).

\textsuperscript{1014} ACRSC Decision No 147/LS/2009 of 1430H issued 21 June 2009.

\textsuperscript{1015} For instance, most suspension decisions are a result of insider trading and some violators have been suspended for five years and others for three years. However, there is no judicial interpretation regarding suspension period.
and the CRSD in relation to the power of trading suspension. 1016 Article 6(a)(7) of the CML’03 allows the CMA, when it deems necessary, to prohibit or suspend trading in any security in the market. 1017 On the other hand, art 59(a)(5) of the CML’03 states that a suspension should be requested by the CMA to the CRSD. Therefore, a clear articulation is needed for the use of this power.

In most developed and mature securities markets, it is argued that a trading suspension is an effective method to make companies comply with, for example, disclosure policy and to ensure that they provide new and material information to the market. 1018 By contrast, an empirical research carried out by Engelen, Grabowski and Kawinska, concludes that temporary trading suspension might not be effective in emerging securities markets. 1019 This is due to the fact that during the suspension, investors are expected to process new information before trading resumes. This will affect the share prices and therefore weaken the integrity of the market. The Saudi securities market is still in need of clear and direct provisions concerning this remedy.

Furthermore, there is the sixth court remedy barring the violator from acting in certain capacities, whereby the court bars ‘the violating person from acting as a broker, portfolio manager or investment adviser for such period of time as is necessary for the

1016 The power of the CMA to interfere and suspend trading will be later discussed in detail in Chapter 10 ‘Regulator’s Role in Enforcing the Disclosure Regime’.

1017 For the CMA decision to suspend trading in Bishah Agricultural Development Corporation because of non-compliance with continuous disclosure requirements, see Capital Market Authority, ‘Announcement Regarding Bishah Corporation’, above n 922. In addition, this remedy is mostly used to suspend securities trading of a violating company, that is, one which does not comply with listing rules and requirement. See, Capital Market Law 2003 art 6(a)(7) ‘[p]rohibit any Security or suspend the issuance or trading of any Securities on the Exchange, as the Authority may deem necessary’.


safety of the market and the protection of investors’. 1020 This remedy concerns brokers, portfolio managers and investment advisors. As per art 59(a)(6), there are two purposes for this temporary bar against liable persons mentioned in this provision. The first is investor protection. Therefore, a breach by a broker, portfolio manager or investment advisor is subject to a temporary bar on that person acting in their professional capacity. The second is the important purpose of maintaining the stability and integrity of the market overall.

Because of the important role played by market professionals, brokers and dealers in securities markets, it is not surprising that the securities laws apply sanctions against these professionals. 1021 Nevertheless, it may be said that this remedy is inadequate. The reason for this is that despite there being other professionals involved in the trading of the secondary market and having to comply with the securities laws and regulatory rules, they are not included in this remedy. Those professionals are, for example, credit rating agencies, accountants, lawyers and experts working for listed companies. 1022

Moreover, the CML’03 and the CMA rules and regulations do not indicate if there is a review committee to determine an appropriate length of suspension or ascertain whether the temporary bar is ended or not. The absence of a methodology and criteria for a temporary bar persists in the Saudi securities laws. In fact, despite the regulatory power

1020 Capital Market Law 2003 (Saudi Arabia) art 59(a)(6).
1022 Market professionals owe duties to their clients. Specifically, market professionals should act with 'loyalty and dedication to maximize their clients’ interests’. See art 57 of the Securities Law 2002 (Jordan).
given to the CML, there have been no efforts to establish an independent committee to assess the suspension period.\textsuperscript{1023}

Establishing a mechanism for temporary suspension of trading is imperative to protect the investors. A temporary suspension is also known as a ‘break’ in securities markets. A ‘break’ means a suspension of trading in the given share, a period during which no bids or offers can be made for them.\textsuperscript{1024} In order to avoid ill-effects on the well-being of investors or the operation of the stock market, regulation is needed to establish a proper mechanism and a separate body to assess the trading suspension in the SSE. However, in addition to the above, remedial courts powers extend to include seizing property, imposition of a travel ban and barring companies whose securities are traded on the SSE. These remedies require further investigation in regard to whether they are effective in protecting investors and deter wrongdoers.

8.6.2 General Weaknesses Concerning the Remedial Courts Powers

Despite the fact that the regulator has broad powers (under art 59 of the CML’03) to institute civil suits on behalf of investors, these powers are unclear. The ambiguity of art 59 is confirmed by Beach who argues that ‘it is ambiguous on the issue, stating that only the CMA may come before the CRSD to seek an order for the appropriate sanction’.\textsuperscript{1025} This makes the investor’s right to sue unclear. Compared with the US, although art 59 is presented in a concise and direct format, Saudi law presents the

\textsuperscript{1023} See Capital Market Law 2003 art 21(a)(8), ‘a. The Board of Directors of the Exchange shall propose the necessary regulations, rules and instructions for the operation of the Exchange including the following matters: 8. ‘Any other rules and instructions that the Exchange deems necessary for the protection of investors through ensuring fairness, efficiency and transparency in all of the Exchange’s related affairs’.


\textsuperscript{1025} Beach, above n 24, 350–1.
powers of the CMA with less specificity. It is too general and broad.\textsuperscript{1026} In addition, art 59 does not specify the type of contravention that is going to be a subject of the above sanctions.

From a practical point of view, several reasons have contributed to the fact that the majority of aggrieved investors are unaware that they have been victims as a result of violation of disclosure requirements. Additionally, other investors do not have the desire to bring an action to the court, even though they have known that they were victims of such violation. The prime reason for this is the weak role of the CMA in protecting the investors which undermines the investor confidence in the securities courts.\textsuperscript{1027} These courts and their members are also inefficient, as demonstrated earlier in terms of specialist knowledge, expertise, training, availability and access; and, perhaps more pertinent here, they appear to have little function in practice in gaining compensation for victims.

Arguably, there are further reasons which have contributed to the lack of investor recourse to the courts for remedial action. These reasons are: the absence of the legal knowledge amongst investors, the possibly small amount of their loss, the cost of litigation, and the delay in delivering the judgments. Questions remain, therefore, as to how the general investors initially can know that their loss was not normal but rather resulted from a breach of the law,\textsuperscript{1028} and how such general investors can prove their right to compensation.

\textsuperscript{1026} Ibid.
\textsuperscript{1027} The role of the CMA will be discussed in depth in the next chapter which is about the administrative enforcement of the securities laws in Saudi Arabia.
\textsuperscript{1028} Fahad Althanyan, ‘The Announcement of the CMA Regarding the Right of Victims to Sue Is Inadequate’, \textit{Alriyadh} (online), 13 February 2010.
By tracking cases brought by the CMA against some violators of the securities regulations, it appears that the CMA has recovered SAR 295 million (USD 78.6 million) which constituted illegal gains unjustly obtained from investors. It could be argued, particularly by investors who have sustained losses, that legislation should provide that fines could be levied to help fund the courts, it would appear more ‘just’ if such amounts contributed to compensation for aggrieved investors who sustained loss or damage because of the violations of the law. Such a change would obviously require legislative change. The fact, however, that the aggrieved investors currently receive no compensation but rather only a sense of satisfaction that court proceedings were successful, they are likely to remain reticent to attempt to bring the matter to court due to the stress, and time and effort it will take, unless it is a particularly large loss or they observe the company continuing to take advantage of other investors through poor disclosure or other practice.

Nevertheless, once a guilty verdict is decided, aggrieved investors can then take action to sue the wrongdoers.

In the early days of the CMA, the body failed to announce that they had recovered significant amounts of money from the violators, so no investor knew that these amounts were effectively ‘stolen’ from them. This is because the CMA either did not announce the name of the company or they did not declare it at the time of the violations. Hence, how during that period could those injured investors know of any violation and realise that the damages they had sustained were actually due to a

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company failing to fulfil its obligations, rather than just the natural fall of the market or due to a legitimate cause, and — in order to gain compensation — prove it as well?

However, the CMA recently announced that every investor can sue those violators who are proved to be guilty. Thus, once aggrieved investors prove they are victims of market violations they can claim their loss or damages in a maximum period of five years from the date of violations. Article 57 of the CML’03 provides any person who buys and sells security the price of which has been ‘significantly and adversely’ affected by such manipulation can sue for the amount their purchase or sale price was so affected.

Indeed, the presence of law firms experienced in compensation cases in the securities market is essential for the investor private right for compensation. Having such law firms will facilitate private enforcement and assist the securities courts in civil litigations. This of course will strengthen judicial enforcement and therefore investor protection.

Consequently, it can be said that, despite the fact that there are a variety of legal and equitable remedies available to deal with breaches of disclosure provisions, implementing these remedies against violators needs to be ensured. The position of investors is further weakened by the fact that securities class-action lawsuits are not expressly permitted under Saudi securities laws, as is discussed in Chapter 6. The absence of class actions will weaken the protection of investors.

\[1030\] See section 6.6.2.

In general, it can be observed that judicial enforcement is impeded by the weakness of the CMA in its role and exercise of its authority to protect the public and bring actions against the violators of the disclosure regime. For that reason, the current situation is that wrongdoers go unpunished and victims remain uncompensated. Hence, public confidence in it will be impaired and, in turn, the financial market will be harmed, as investments will flow in directions other than the securities market. Consequently, it can be said that the present remedies are ineffective to compensate victims nor to create deterrence in regard to disclosure contraventions.

8. 7 Summary and Conclusions

Protection of investors is unachievable without the reinforcement of their legal rights. The adjudication of business disputes requires an effective and independent judiciary that ensures the rule of law. The enforcement of laws by courts is seen to play an effective role to protect investors and thus encourage investment in securities markets.

In Saudi Arabia, it has been found that although the enforcement of the legal rights of investors is of vital importance, the enforcement figures are poor. Moreover, despite the CML’03 establishing specialised securities courts with jurisdiction over disputes arising from the securities market, shortcomings continue to prevail. In general, several reasons have been found for the ineffective judicial enforcement of securities laws and, in particular, civil liability provisions. These are: the inadequate number of securities courts; the lack of experienced and efficient judges and lawyers; poor performance of ...
the CRSD due to its weakness; the ineffective role played by the CMA in bringing civil suits on behalf of investors; and the drawbacks associated with the remedial powers of the securities court in Saudi Arabia.

It has been argued that the protection of investors has been weakened by the inefficient enforcement of securities laws. Thus, it is noted that improvements are required in order to achieve an effective judicial enforcement of securities laws.

In view of the present situation, members of the securities courts lack accountability. There are no specific standards or requirements for the evaluation of the performance of the securities courts. As described earlier, the CRSD can issue civil, administrative and penal decisions, including imprisonment. Leaving its members without accountability may lead to undermining their performance.

In brief, it is suggested that reforms of the judiciary are required to effectively deal with cases arising from the securities market. In addition, amendments are required to be made to art 25 of the CML’03. This is because this article governs the formation and the criteria of the selection of members for the CRSD and ACRSD. The law is required to be properly enforced; for this it requires more courts and judges provided and greater assurance of judicial independence. Equally important, it is necessary for a statutory securities class action to be available to the general investor to provide better protection to investors. The interpretation of the sanctions and remedies of art 59, especially with the enforcement of civil liability provisions is also necessary, as argued earlier.

The role of the CMA as the regulator of the market has to be more effective. Issuing rules and regulations to foster the confidence in the market should be a fundamental task of the CMA. This would lead to better functioning of judicial enforcement. Thus, it is
agreed that an appropriate legal framework encourages the objective enforcement of laws and the related regulatory framework.\textsuperscript{1035}

The quality and effectiveness of the judiciary is significant for successful enforcement of securities laws.\textsuperscript{1036} A recent study comments that ‘[a] well-developed modern court system to apply the law and dispense justice is an important component of a modern legal system based on the rule of law. Saudi Arabia lacks such a system’.\textsuperscript{1037} Thus, it has been suggested that there is a real need for securities law schools, experts and more research in order to enrich the knowledge of securities literature amongst judges and lawyers.

Strong legal frameworks and efficient courts deter illegal practices, increase benefits to market participants, and thereby prevent debacles in securities markets. A recent study on the recent global financial crisis suggests that a proper enforcement of corporate law by efficient legal institutions may prevent future financial crises.\textsuperscript{1038} In other words, ‘weak legal institutions can contribute to economic crises’.\textsuperscript{1039} In Saudi Arabia, lack of confidence in the judiciary precludes investors from going to law courts for judicial remedies. Investors are either reluctant or incapable of going to court for judicial remedies. Recently, SSE financial analysts deduced that laws and regulations of the SSE require reforms associated with fair trial and the need for transparency in


\textsuperscript{1037} Esmaeilii, above n 324, 34.


\textsuperscript{1039} Johnson, above n 668, 13.
Chapter 8: Judicial Enforcement

dealings.\textsuperscript{1040} The current judicial enforcement of disclosure regime has proved to be ineffective in protecting investors in the securities market in Saudi Arabia. In addition to judicial enforcement, the administrative enforcement of securities laws is a crucial mechanism to the entire enforcement regime. The following chapter will discuss the issues of administrative enforcement.

\textsuperscript{1040} Alhilali, above n 997.
9. 1 Introduction

Successful investor protection requires strong laws and enforcement. Investor protection in securities markets relies on having an effective regulator that can implement the laws and act on behalf of the public interest. There is a close relationship between credible enforcement rule that particularly protects minority shareholders and the development of the securities market. The power of the regulator to enforce securities laws is generally ‘conceived of as comprising the investigation of possible violations of the law and the taking of appropriate action either administrative, civil or criminal to restrain or to punish those responsible for any violations found to exist’.

In this chapter, the term ‘administrative enforcement’ refers to the enforcement of securities laws by the administrative or regulatory authorities. The significance of administrative enforcement of the disclosure regime in Saudi Arabia is derived from the fact that the judicial enforcement is weak, as discussed in the previous chapter. When judicial enforcement is inadequate in protecting investors, an efficient regulator can provide this protection. Moreover, having effective administrative enforcement is essential to maintain and improve the capital market. Consequently, the role of the regulatory body is significant in terms of the investor protection and market growth.

Nevertheless, since the inception of the Capital Market Authority (CMA) in 2004, there have been numerous allegations made against the regulatory body of the securities

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1043 Johnson, above n 668, 10.
market in regard to its functioning. As the Saudi stock market has grown rapidly over the past decade, the potential for corporate malfeasance is very high. The CMA is responsible for restoring confidence to the stock market by enforcing laws and regulations that pertain to companies and financial intermediaries. Over the past few years, the CMA has been unsuccessful in restoring investor confidence in the capital market. This is because of the lack of success in protecting investors — the securities market still suffers from disclosure violations,\textsuperscript{1044} wrongdoers are going unpunished and aggrieved investors are sustaining loss or damage. Thus, issues of administrative enforcement of the disclosure regime need to be addressed with the objective of discovering the underlying shortcomings of the current management of the disclosure regime and drawing up recommendations to make the regulatory body effective. Moreover, this chapter highlights a number of weaknesses. These weaknesses hamper investor protection which is the core objective of securities regulation. Further, reforms are needed to be made by the Capital Market Authority (CMA) to produce a transparent, developed and fair market.

To this end, the discussion in this chapter begins with an introduction in section 1. Section 2 describes the current function and mechanism of the securities regulator in Saudi Arabia. Section 3 investigates the current drawbacks associated with the administrative enforcement of the disclosure regime. Section 4 discusses the drawbacks of the current securities regulatory body in regard to the disclosure regime in Saudi Arabia. Section 5 focuses on the important role played by the regulator in enforcing securities laws. Section 6 discusses the essentials of the regulatory function in enforcing

the disclosure regime. Section 7 draws conclusions which will demonstrate that the present administration has been ineffective in providing protections to the investors.

9.2 Present Administration of the Disclosure Regime in Saudi Arabia

Currently, the CMA is responsible for the administration of the securities market in Saudi Arabia. As is evident from the description in Chapter 4, the CMA is the sole regulator for the securities market regulation. The disclosure requirements are, in particular, provided in the Capital Market Law 2003 (CML’03). The CMA issues additional regulations rules and rules regarding the disclosure requirements. According to art 5(a) of the CML’03, ‘The Authority shall be the agency responsible for issuing regulations, rules and instructions, and for applying the provisions of this Law’.

Article 6 of the CML’03 gives the CMA the power to issue the associated regulations and instructions, and to prescribe procedures necessary for regulating and monitoring the disclosure process. Moreover, the CMA alone is responsible for the administration of the disclosure regime. Article 5(a)(6) of the CML’03 states that the CMA is entitled to:

regulate and monitor the full disclosure of information regarding Securities and their issuers, the dealings of informed persons and major shareholders and investors, and define and make available information which the participants in the market should provide and disclose to shareholders and the public.
9.2.1 Regulatory Enforcement Tools

The CML’03 gives the CMA broad authorities and powers so that it can carry out its function efficiently.\(^{1045}\) In respect of enforcement against breaches of the disclosure requirements, the CML’03 empowers the CMA with a number of enforcement tools that can be used in regard to contraventions of the securities regulations. These tools are stated below:

(i) The members of the CMA and its employees designated by the Board of the CMA (BCMA) are empowered to subpoena witnesses, take evidence, and require the production of any books, papers, or other documents which the Authority deems relevant or material to its investigation.\(^{1046}\)

(ii) The CMA shall have the power to carry out inspections of the records or any other materials, whoever the holder may be, to determine whether the person concerned has violated, or is about to violate any provision of this Law, the Implementing Regulations or the rules issued by the CMA.\(^{1047}\)

(iii) The CMA can suspend the activities of the stock exchange for a period of not more than one day; and in cases where the Authority or the Minister of Finance deems it necessary to suspend the Exchange’s activity for more than one day, the approval of this decision must be issued by the Minister of Finance.\(^{1048}\)

(iv) The CMA can approve, cancel or suspend the listing of any security issued by Saudi company and traded on any stock exchange outside the Kingdom.\(^{1049}\)

\(^{1045}\) See details in Chapter 3 ‘Legal and Regulatory Framework of Securities Market in Saudi Arabia’.
\(^{1046}\) Capital Market Law 2003 (Saudi Arabia) art 5(c).
\(^{1047}\) Ibid.
\(^{1048}\) Ibid art 6(a)(5).
\(^{1049}\) Ibid art 6(a)(6).
Chapter 9: Securities Regulator’s Enforcement

(v) Prohibit any security or suspend the issuance or trading of any securities on the Exchange, as the Authority may deem necessary.\textsuperscript{1050}

Moreover, in addition to the CMA’s power to seek orders before the courts as discussed in the previous chapter,\textsuperscript{1051} the CML’03 provides the CMA with the power to impose monetary fines on the violators of the securities laws and regulations. Article 59(b) of the CML’03 provides that:

The Authority may, in addition to taking the actions provided for under paragraph (a) of this Article, request the Committee to impose a financial fine upon the persons responsible for an intentional violation of the provisions of this Law, its Implementing Regulations, the rules of the Authority and the regulations of the Exchange. As an alternative to the foregoing the Board may impose a financial fine upon any person responsible for the violation of this Law, its Implementing Regulations, the rules of the Authority and the regulations of the Exchange. The fine that the Committee or the Board can impose shall not be less than SAR 10,000 (USD 2,666) and shall not exceed SAR 100,000 (USD 26,665) for each violation committed by the defendant.\textsuperscript{1052}

Thus, it appears that the CMA may impose such a fine on anyone liable for the violation of the CML’03 or its regulations, but, unlike where the CRSD is the relevant body, there is no requirement to establish that such violation was ‘intentional’. The CMA can impose the same fine on anyone liable for the violation, apparently even if such violation was ‘unintentional’. In order to ascertain / illustrate the application of the enforcement provisions, recent reports of CMA administrative actions will be presented and then the current enforcement machinery will be examined.

\textsuperscript{1050} Ibid art 6(a)(7).
\textsuperscript{1051} With such court orders comprising: ‘warning the person concerned; obliging [him] to cease or refrain from the act that is the subject of the suit; obliging the person to take the necessary steps to avert the violation’ or take the ‘necessary steps’ to correct its results; indemnify those who have suffered damage due to the violation, or obliging the violator to pay into the CMA account any gains realised thereby; suspension of trading; bar on professional practice (period determined by CMA); seizure and sale of property; travel ban; ban on working with companies whose shares are traded on the SSE: \textit{Capital Market Law 2003} (Saudi Arabia) art 59(a).
\textsuperscript{1052} The ‘Board’ refers to the Board of the Capital Market Authority.
9.2.2 Some Relevant Recent Publicly Reported CMA Administrative Actions

The CMA has undertaken a number of actions in the exercise of its administrative powers over the Saudi Stock Exchange (SSE). A number of those recently reported are found immediately below.

(i) In December 2011, the CMA imposed a penalty of SAR 100,000 (USD 26,665) on the Advanced Petrochemical Company because of the violation of periodic disclosures requirements prescribed in art 45(c) of the CML’03.\textsuperscript{1053} The news of the company’s preliminary financial results had been leaked to a website on 5 October 2011, before the CMA and the public were informed.

(ii) In November 2011, the CMA imposed a penalty of SAR 50,000 (USD 13,332) on the Saudi Fisheries Company because of the violation of the continuous disclosure requirements prescribed in art 46(a) of the CML’03 and art 25 of the Listing Rules (LR’04).\textsuperscript{1054} The company had failed to inform both the CMA and the public of changes in its senior management when these occurred.

(iii) In October 2011, the CMA imposed a penalty of SAR 50,000 (USD 13,332) on the National Petrochemical Company (PETROCHEM) because of the violation of art 46(a) of the CML’03 and art 25 of the LR’04.\textsuperscript{1055} The company had failed to inform both the CMA and the public of the capital increase for its affiliate ‘Saudi Polymers Company’.

(iv) In January 2012, the CMA imposed a penalty of SAR 50,000 (USD 13,332) on Tihama Advertising & Public Relations Co due to its violation of art 46(a) of the

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CML’03 and art 25 of the LR’04. The company had failed to inform both the CMA and the public of its participation in establishing the Gulf System Development Company (Gulf Tech) with the Dar AL-Mustored Group and Zakha Trading Institute.

In situations where the CMA could seek an action before the Committee for the Resolution of Securities Disputes (CRSD), the law is clear that the CMA’s decision to fine is an alternative to the CRSD fine, but in addition to other CRSD orders that have been applied for to the CRSD by the CMA. Hence, art 59(a) of the CML’03 does not clearly state whether the CMA must wait for the CRSD to act in regard to those orders (or issue a decision in relation to any fine to be imposed) prior to the BCMA itself imposing a fine. Even if such a conclusion is reached, the CMA will need to issue guidance on the conditions precedent to any action taken by the CMA earlier than any decision being reached by the CRSD.

It should be noted that since the CMA began its operation in 2004, the CMA’s enforcement and market supervision functions have improved rapidly. One of the most important powers given to the regulatory body for securities regulation is the power to make an appropriate order in the public interest. As discussed in the previous chapter, the CMA can bring civil suits before the court on behalf of the aggrieved investors.
9.2.3 Present Enforcement Machinery

The CMA declares that its main mission in enforcement is to protect investors from unfair and unsound trading, detect and ensure prosecution in relation to disclosure violations, and ensure that securities business is undertaken with transparency in securities transactions. The CMA’s enforcement powers are exercised by four departments as follows:

i. **Investigation Department**: The role of this Department is to oversee all investigations processes, gather evidence, carry out interrogations and interviews of suspects, and recommend appropriate actions to the BCMA. Its main functions are: investigating violations referred by different sources; investigating electronic violations; requesting data and records from internal and external sources that support the investigation; and subpoenaing suspects and witness for interview and interrogation.

ii. **Prosecution Department**: Its role is to prosecute criminal violations and unfair or offensive exploitation in the capital market before the CRSD and the Appeal Committee for the Resolution of Securities Conflicts (ACRSC). Its main functions are: preparing and constructing prosecution memoranda for cases received from the investigation department and, subject to the approval of the BCMA, prosecuting cases before the CRSD by attending the hearing of cases put forward by the CMA and responding to the answers provided by the accused; and appealing CRSD decisions before the ACRSC.

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1059 Ibid.
1060 Ibid.
iii. The *Enforcement Follow-up Department*: This Department is responsible for implementing decisions issued by the BCMA, the CRSD and the ACRSC. These decisions consist of the freezing of assets (including bank and investment accounts of offenders); imposition of travel bans, financial penalties, trading bans, and imprisonment. Its main functions are: coordinating continuously with the CMA departments concerned and other agencies related to the implementation of decisions; issuing letters notifying violators of decisions to be implemented; and following up with violating firms and persons in regard to their implementation of those decisions.1061

iv. *Investors’ Complaints Department*: Its objective is to protect investors by receiving and reviewing complaints, and by undertaking settlement processes between disputing parties. If settlement is ‘not reached within 90 days from the filing [of] the complaint, a formal notification will be given to the complainant for filing the case with the CRSD’.1062 The main functions of this department are: receiving and scrutinising investors’ complaints; gathering and analysing relevant data and documents from disputing parties; conducting settlement processes with disputing parties; issuing notices and letters of notification in cases where there no settlement is reached and the parties wish to follow up on the complaint in front of the CRSD.1063

The above description of the current regulatory body shows that the CMA is the sole regulator and enjoys broad statutory powers and functions. The CMA is empowered to protect the investors, supervise and regulate the securities market.

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1061 Ibid.
1062 Ibid.
1063 Ibid.
Chapter 9: Securities Regulator’s Enforcement

The most recent comparison between the stock markets in the Arab and Gulf countries found that the Saudi Arabian securities market is the most structurally independent market in the performance of its functions.1064 Moreover, the CMA enforcement decisions provided above show that the regulator is working toward better implementation of the law. The CMA’s enforcement decisions aim to deter potential offenders and to ensure full compliance with the disclosure regime. Investor loss or damage due to defective disclosures could thereby be decreased. In addition, the monetary fines imposed by the CMA on the offending companies endeavour to restore public confidence in the securities market. It attempts to show the public that the regulator has effective law enforcement and appropriate sanctions against those who do not comply with the CMA’03 and CMA rules and regulations in general. Nevertheless, compliance with the disclosure regime requires additional attention by the administration of the Saudi Stock Exchange (SSE). It is argued that despite the significant developments achieved by the CMA in the past few years, shortcomings still exist in the CMA’s role in protecting investors from violations of the disclosure regime.

With this in mind, the following section will endeavour to identify the existing drawbacks of the current administrative enforcement of disclosure regime in Saudi Arabia. Then, these drawbacks will be discussed and evaluated in order to demonstrate that the current administrative enforcement is insufficient. In order to do that, there will be discussion of the importance of the regulator and the fundamentals of regulatory function regarding administration of the disclosure regime.

9.3 Existing Drawbacks of the Current Administrative Enforcement Machinery

Generally, the major goal of the enforcement of the securities laws is to provide protection for the participants in the market, especially the investors. Any failure in providing such protection will draw attention to administrative enforcement and to whether it is effective or not. Failure in this regard will indicate that shortcomings exist and need to be solved. An empirical study was carried out in 2006, which found that the failure of the regulator to use many of the CMA’s strategies in the regulation of the SSE created a significant weakness in the CMA’s role in protecting investors.1065

Over the past few years, the CMA’s enforcement and market supervision functions have become more prominent. Nevertheless, weaknesses of the regulatory enforcement of the disclosure regime continue to exist. The weak enforcement machinery can be clearly seen through several issues. These issues, amongst others, are: a lack of transparency in operation; inadequacy of monetary fines; weak intervention by the CMA; and lack of uniformity in the exercise of the regulator’s powers.

9.3.1 Lack of Transparency

In fact, there have been widespread allegations concerning the ineffectiveness of the current administration of the disclosure regime. As a result of the notable market debacle in 2006, the Saudi stock market suffered from a loss of investor confidence, which still desperately needs to be restored.1066 The CMA has failed to restore public confidence in the securities market. Two legal advisors claim that the CMA requires

reform in respect of the laws and regulations, levels of disclosure and transparency in dealings.\textsuperscript{1067} They maintain that the significantly weak performance of the CMA led to the collapse of 2006 and the subsequent loss of shareholders’ investments.\textsuperscript{1068} The non-compliance with the disclosure regime by listed companies is due to the absence of precise monitoring of these companies. Many claim that investors are not protected and that many violations occur without being discovered by the CMA.\textsuperscript{1069} This will raise the question of whether the CMA has an efficient system to detect violations of the disclosure regime.

Furthermore, the ineffective enforcement by the CMA has been responsible for the non-compliance with continuous disclosure requirements. There have been examples of delays in announcing major developments and news of a company, which have affected the security’s price and therefore caused loss or damage for other investors. The CMA and listed companies suffer serious problems in determining whether information is material or not. Certainly, the regulator is responsible for the administration of continuous disclosure and for monitoring compliance by companies.

So far, there have been no studies carried out by the CMA to assess transparency in the market, and public satisfaction and confidence in the market. Thus, the issue of market regulation becomes difficult, especially given the serious lack of extensive legal research on the aspects of the administrative enforcement of securities laws in Saudi Arabia.

\textsuperscript{1067} Alhilali, above n 997.
\textsuperscript{1068} Ibid.
\textsuperscript{1069} Ibid.
9.3.2 Inadequacy of Monetary Fines

Although there have been fines imposed on some listed companies for breach of the disclosure regime, there are still many companies which are not complying with disclosure requirements in the secondary market.\(^{1070}\) Monetary fine refers to an administrative action imposed by the CMA not by court, as one of several regulatory enforcement actions.

Considering the enormous financial ability of firms, the amount of the monetary penalty does not create deterrence. For that reason, it is argued that the imposition of a maximum fine of SAR 100,000 (USD 26,665) for each violation committed is too lenient.\(^{1071}\) A recent commentator declares that listed companies do not fear of the CMA’s monetary fines because these fines are simple (and low) compared with the serious nature of the disclosure violations committed.\(^{1072}\)

In contrast, in the UK, the ability of the Financial Services Authority (FSA) to sanction breaches of the Disclosure and Transparency Rules (DTR) involves a potentially indefinite amount of penalty, payable to the agency, as provided for in s 91 of the

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\(^{1070}\) For example, the CMA in 2008 imposed monetary fines on a number of listed companies that had failed to disclose their results for the year 2007 within the period specified in art 26 of the Listing Rules 2004 (Saudi Arabia), which states: ‘The company must provide the Authority and announce to the shareholders its annual accounts as soon as they have been approved and within a period not exceeding 40 days after the end of the annual financial period.’ The BCMA imposed a penalty of SAR 10,000 (USD 2666) on each of the companies here listed: Emaar the Economic City, Mediterranean & Gulf Insurance Company, Anaam International Holding Group Company, Malath Insurance Company, SANAD Insurance Company, Saudi Franssi Insurance Company, SABB Takaful Company, and Ashargiyah Agriculture Company. See Capital Market Authority, ‘Imposition of Penalties on Companies that Failed to Disclose their Annual Financial Statements for 2007’, above n 659.

\(^{1071}\) Ramady, above n 104, 151.

\(^{1072}\) Mohammed A Alismail, 'No One Fears the Capital Market Authority Sanctions', Alyaum (online), 10 May 2012 <http://www.alyaum.com/News/art/49621.html> [Arabic].
Financial Services and Markets Act 2000 (FSMA 2000). Davies describes the unlimited monetary fine as ‘the primary weapon in the hands of the FSA’. 1073

In a recent case, the US Securities and Exchange Commission (SEC) imposed a USD 1 million administrative penalty against Pipeline Trading Systems LLC for misleading investors and providing defective disclosure in connection with the sale of securities. 1074 This case shows that the amount of the fine is significant where such a fine aims to create deterrence and consequently compliance with the disclosure requirements. In respect of effective enforcement and deterrent fine, Coffee affirms that ‘[e]nforcement can be measured either in terms of the number of enforcement actions brought or the aggregate financial sanctions levied’. 1075

In general, the objective of the monetary fines is to create a level of deterrence that will lead to compliance. The current situation in Saudi Arabia is that not only is the number of administrative fines issued fewer than might be expected given the size of the market, but the amount of each administrative fine is low and hence deterrence is not created. The level of the administrative penalty has to be in line with the severity of the breach that caused loss or damage for the market and investors. However, punishing the company may have a subsequent effect on the investors of the company. Therefore, as the companies’ directors are responsible for the management and function of the company, they should be also liable for the company’s behaviour. In the Saudi securities industry, increasing the level of the monetary sanctions is essential for the stability of the market. However, it is recommended that the regulator establish rules for the monetary fines and be given the authority to measure the breach and then impose a

1074 Grewal, above n 657.
suitable fine on the company in question. Moreover, regulator must not misuse this power and there should be an independent bench to monitor the regulator’s enforcement.

In Saudi Arabia, breaches of the disclosure regime continue to impair the efficiency of the SSE. According to the CMA 2011 annual report, the cases of disclosure violations formed the highest percentage of violations during the years 2010 and 2011. There were 130 cases of disclosure violations of the total of 541 investigation cases into suspected violations. Enforcement that fails to create deterrence is ineffective. The deterrence approach to enforcement aims to use penalties and prosecutions to deter breaches of the law. A study on the Australian Securities and Investments Commission (ASIC) enforcement of disclosure regime argued that the adoption of an approach of deterrence is ‘effective in creating healthy corporate culture and improve standards of behaviour’.

9.3.3 Weak Intervention

The lack of protection for investors is evident in the inability of the CMA to detect violations of the market regime. The relative lack of intervention by the CMA in regard to disclosure violations could harm public confidence, as the wrongdoers go unpunished. It could be due to the regulator’s inability to supervise the market, as well as its weak detection and investigation activities. On the other hand, the CMA is entitled to issue rules and regulations that can create more protection for investors.

Additional protection in respect of disclosures in the initial public offerings (IPOs) market is imperative. In reality, the role of the CMA is unclear in respect of protecting

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1077 Raykovski, above n 560, 289.
investors from breaches of the disclosure requirements in a prospectus. For example, there is absent from the statutory powers of the regulator the power to issue a stop order against an IPO where it (the IPO) turns out to be defective.\textsuperscript{1078} In contrast, ASIC can issue a stop order on a prospectus that lacks clarity in its information content. Section 739(1) of the \textit{Corporations Act 2001} (Cth) clearly provides ASIC with the power to issue stop orders regarding defective prospectuses.\textsuperscript{1079} For instance, ASIC issued a stop order on a prospectus due to concerns that investors and their professional advisers would not be able to make an informed assessment of the company’s prospects based on the information contained in the prospectus.\textsuperscript{1080}

Although the CMA has enforcement tools accorded it by the CML’03 and possesses enforcement machinery through its departments to oversee (detect and prosecute) violations and carry out enforcement, the detection and investigation departments in the CMA may require reform. Unlike the CMA, general investors do not have the ability or the technology to detect disclosure violations in the market. Thus, if the CMA fails to detect and conduct an adequate investigation, investors will certainly be unable to discover these violations that cause loss and damage to their investments. This will allow wrongdoers to go unpunished and victims remain without compensation. As a result, public confidence in the securities market has been significantly weakened.

\textsuperscript{1078} See section 9.6.1.2.1 which discusses the power of the stop order.

\textsuperscript{1079} \textit{Corporations Act 2001} (Cth) s739 states the stop order power can be ordered by ASIC if:

\begin{enumerate}
  \item Information in a disclosure document lodged with ASIC is not worded and presented in a clear, concise and effective manner
  \item An offer of securities under a disclosure document lodged with ASIC would contravene s 728; or
  \item An advertisement or publication of a kind referred to in subsection 734(5) or (6) that relates to securities is defective.
\end{enumerate}

9.3.4 Lack of Uniformity in the Exercise of the Regulator’s Powers

The exercise of power by the CMA needs to be balanced. In a number of instances (as outlined above), the exercise of the regulator’s power has been described as lenient in regard to the level of investigation and also in the subsequent imposition of sanctions for wrongdoing related to matters of disclosure. Hence, it can also be argued that the CMA is, like other institutions, affected by a tendency to ‘underestimate the likelihood of fraud [or other illegal activities] during booms and overestimate it following busts’, and thus following a ‘crash’ might be expected to be overly harsh or disproportionate in its actions against companies. The wide and strong powers, given to the CMA by the CML’03, provide it with the ability (at least on paper) to severely sanction offenders or offending entities and, it can be argued, this may in some jurisdictions have led to a misuse of power, which has in turn may have had a negative impact on investors. As Aviram notes, a ‘significant increases in enforcement actions when the market index declines and decreases in enforcement actions when the market index rises significantly’.\(^{1081}\) It is unlikely to be said generally of the CMA, however, due to its weak use of the available powers (as outlined earlier).

Some investors have left the market because of the regulator’s failure to use the powers available or due to the overuse of these powers. The CMA’s use of its power at times is lenient or at other times too harsh, reflecting an ignorance regarding issues in regard to the proper control of the market.\(^{1082}\) A recent report released by the Saudi Arabian Monetary Agency (SAMA) shows that the Saudi investors have moved from domestic to foreign markets, which is illustrated by the extent to which total investment flows


\(^{1082}\) Albsalei, ‘Legal Excesses by the CMA Lead to Investors Fleeing’, above n 927.
flowed out of the Saudi securities market from the beginning of 2006 to the end of the fourth quarter of 2011. These funds have reached more than SAR 278.8 billion (USD 74.4 billion).\(^{1083}\)

The CMA is supposed to be responsible for making stringent regulations to control speculation in the market. Instead, the CMA has — through the media — asked investors to stop their speculative activities voluntarily in order to maintain and support the growth in the market.\(^{1084}\) In fact, the CMA is required to perform its role as a regulatory organisation whose task it is to oversee the market. Hence, the CMA is entitled to issue rules that provide the market with stability and provide conditions for success. Black suggests that ‘[t]he core regulatory role is enforcing standards of conduct against issuers and reputational intermediaries who flagrantly violate the disclosure rules, not tweaking the rules at the margin’.\(^{1085}\) Effective administrative enforcement requires efficient regulations and rules by the securities market regulator. Thus, it is imperative that practical steps be taken towards regulation and prevention of unfair practices in the market in order to provide better protection for investors and thereby attract investment to benefit the market by large.

Furthermore, one study blames the CMA for contributing to the market collapses of 2006 and 2008.\(^{1086}\) It claims that the CMA’s performance was weak with regard to preventing illegal practices in the market prior to the collapses.\(^{1087}\) In addition, the CMA’s release of news and announcements once the collapse had begun significantly


\(^{1087}\) Ibid.
Chapter 9: Securities Regulator’s Enforcement

contributed to the market’s downfall. According to Abdulsalam, the CMA announcements were not professionally executed in a timely and considered manner during the boom and during the market collapse, which led to the weakening of public confidence in the market. Another recent study found that investor loss can also be due to the negative response of the market to a regulatory enforcement announcement. This is because the regulatory enforcement announcement will affect the company value in the market. For example, a US court found that there were no grounds for the second SEC enforcement action against Siebel based on a failure to maintain adequate disclosure controls, yet the company lost 4.52 per cent of market, model-adjusted value on the day of the SEC news. This indicates the significance of the news released by the market regulator and therefore this news needs to be carefully assessed prior to its release.

As an added point, it can be said that despite the CMA having the power to suspend trading in securities or take other appropriate action, there is no suspension period specified under the CML’03 and the CMA regulations. Article 6(a)(7) of the CML’03 states that the CMA shall have the power to ‘[p]rohibit any security or suspend the issuance or trading of any Securities on the Exchange, as the Authority may deem necessary’. In contrast, § 12(k) of the Securities and Exchange Act 1934 (US) (SEA’34) allows the SEC ‘to suspend trading in any security (other than an exempted security) for a period not exceeding 10 business days’.

1088 Ibid.
1089 Paul A Griffin, David H Lont and Benjamin Segal, ‘Enforcement and Disclosure under Regulation Fair Disclosure: An Empirical Analysis’ (2011) 51 Accounting and Finance 947, 980.
1091 Griffin, Lont and Segal, above n 1089, 968.
Moreover, a stock exchange generally is required to have a positive duty to provide all reasonable assistance to the regulator. In Australia, the *Corporations Act 2001* (Cth) (CA’01) gives the ASX the right to institute proceedings for violations of the continuous disclosure rules.\(^{1092}\) In Saudi Arabia, the role of the SSE in the administrative enforcement of disclosure violations in the secondary market is absent.

The SSE has only the power to recommend or propose rules to the CMA. According to art 23(a) of the CML’03, the board of directors of the SSE shall propose the necessary regulations, rules and instructions for the operation of the SSE. However, art 23(b) states that any regulations, rules and instructions proposed by the SSE have to be submitted to the CMA for the approval by the BCMA.

On the basis of the above discussion, it can be consequentially said that the need for reforms regarding the administrative enforcement of securities laws in Saudi Arabia is imperative in order to restore public confidence in the capital market. The CMA lags behind when compared with other developed markets. However, in order to demonstrate that the current disclosure regime is weak in protecting investors, it is important to investigate the above weaknesses and hurdles in the current securities regulator in Saudi Arabia. Thus, with the intention of recommending measures to make the regulation effective, the following section of this chapter will discuss the importance of adequate administrative enforcement of disclosure regime in relation to the protection of investors.

\(^{1092}\) *Corporations Act 2001* (Cth) ss 793C, 1101B.
9. 4 **Drawbacks of the Current Securities Regulatory Body in Regard to the Disclosure Regime in Saudi Arabia**

Securities regulation comprises the regulation of public issuers of securities, secondary markets, asset management products and market intermediaries. The securities market regulator is responsible for issuing rules and regulations and ensuring that all market participants are complying with these regulations. In Saudi Arabia, there have been widespread allegations of inefficiency against the CMA in regard to its role in providing an investor friendly securities market. For instance, De Boer and Turner have criticised the role of the capital market adminstrator in Saudi Arabia by pointing out that:

In a country like Saudi Arabia, which is flooded with excess cash, weak capital market and banks prevent adequate funds from reaching small and midsize business, which in most economies are the engine of growth, innovation, and employment. The financial system in Saudi Arabia instead channels funds to large government-owned enterprises and to elite businesses, while starving others.\(^\text{1093}\)

The above shows that the CMA is required to develop the market and make it attractive to investors. However, the flaws that exist in the securities regulatory body appear to have significant negative impact on the stock market in the country. For the development of market administration, the following section will discuss the inefficient regulatory role of the CMA in terms of information intermediation and self-regulatory power.

**9.4.1 Insufficiency in the Regulatory Role of the CMA in Regard to Information Intermediation**

Ongoing development of market related laws is essential for legislative support of the financial market. Despite the legal duty that the CMA has to regulate and develop the market, its regulatory role remains unsatisfactory. This is because the market is in need

\(^{1093}\) Kito De Boer and John M Turner, 'Beyond Oil: Reappraising the Gulf States' [2007](1) *McKinsey Quarterly* 112, 115.
of more by-law regulations to reduce unlawful practices and increase the efficiency in
the market. Comprehensive and effective regulations regarding information
intermediation are central to the role of the regulatory body. Leyens says that
‘[i]nformation intermediation serves to increase the credibility of issuer disclosure and
overcome investor uncertainty’. Providing credible information will lead to
transparent market with a safe investment environment.

Hence, there have been unregulated activities that continue to undermine the reliability
of corporate disclosure. In particular, activities of auditors, financial analysts and rating
agencies are yet to be regulated. It has been stated that

> The most important information intermediaries in capital markets are auditors,
financial analysts and rating agencies. Each of these intermediaries acts within a
multi-layered system of legal duties towards issuers, investors and other market
participants'.

The following will discuss the regulatory role in regard to auditors, financial analysts
and rating agencies in Saudi Arabia. All of them stand in a relationship to the market
and have duties of disclosure and transparency.

9.4.1.1 Auditors and their Role in the Disclosure Process

Auditors have an important role in the disclosure process. The auditor’s job is to verify
the financial statements of a company and provide investors with an independent
assurance that the company’s financial statements conform to the accounting standards.

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1095 Ibid 43.
At this point, the importance of auditors derives from the fact that stock prices respond to earning announcements and investors rely on accounting information.1096

The accounting profession only started to be effectively regulated in the early 1990s. The issuance of the *Certified Public Accountants’ Regulations* in 1991 and the creation of Saudi Organisation for Certified Public Accountants (SOCPA) in 1992 laid the foundation for the accounting profession in Saudi Arabia.1097

In the securities market, the CML’03 empowers the CMA with a supervisory responsibility over the auditing standards and conditions required for auditors who audit the prospectuses and periodic financial statements in the Saudi stock market.1098 The CMA delegates this power to the SOCPA.

In regard to the prospectus, the issuer must have published audited accounts covering at least the last three financial years, prepared in accordance with the accounting standards issued by the SOCPA.1099

Respecting periodic financial disclosures, the issuer must provide the CMA its interim and annual accounts after having them prepared and reviewed in accordance with the standards set out by the SOCPA.

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1097 SOCPA is a professional organisation established under Royal Decree No. M12 dated 1 Jumada al-Ula 1412H corresponding to 19 November 1991G. It operates under the supervision of the Ministry of Commerce in order to promote the accounting and auditing profession and all matters that might lead to the development of the profession and upgrading its status.
1098 *Capital Market Law 2003* (Saudi Arabia) art 6(a)(9): ‘The Authority shall have the right to establish standards and conditions required for the auditors who audit the books and records of the Exchange, the Depositary Centre, brokerage companies, investment funds and joint stock companies listed on the Exchange. The Authority, subject to its supervisory responsibilities, shall have the right to delegate this responsibility to the Saudi Organisation for Certified Public Accountants.’
1099 *Capital Market Law 2003* (Saudi Arabia) art 42(c); *Listing Rules 2004* (Saudi Arabia) art 8.
Chapter 9: Securities Regulator’s Enforcement

Auditors must be independent as stated by art 31(c) of LR’03:

Each issuer must ensure that the accounting firm that audits its financial statements and any partner in such accounting firm comply with the SOCPA rules and regulations in relation to the ownership of shares or securities of the issuer or any of its affiliates in order to ensure the accounting firm’s independence and independence of any partner or employee of that firm.

The accounting firm must abide by the independency requirement that set out by the LR’04. Therefore, the accountants’ report must be prepared by an independent accountant who is a current member certified by SOCPA.

Because of the important role played by auditors in the prospectus and other financial reports issue by a company, auditors should be well trained and experienced. Al-Twaijry et al found that the role of auditors is undermined by the lack necessary financial expertise.\textsuperscript{1100}

However, even where standards are adhered to, the standards do not conform to international standards. Saudi Arabia has established its own accounting standards. A limited number of accounting standards have been issued by SOCPA. It has been suggested that Saudi Arabia adopt the International Accounting Standards Board (IASB) standards in order to enhance the market. The reasons for this are: first, many countries in the world already use IASB standards and as a result foreign investments would be facilitated; and the cost of set up and production of separate and different national accounting standards would be eliminated.\textsuperscript{1101} Recently, SOCPA admitted that


\textsuperscript{1101} Taisier A Zoubi and Osamah Al-Khazali, 'Adopting US-GAAP Or IASB Accounting Standards By The Arab Countries' (2011) 3 International Business and Economics Research Journal 65, 70.
the US Generally Accepted Accounting Principles (US GAAP) should be adopted for those issues not covered by the Saudi’s accounting regulations.\textsuperscript{1102}

Having well-trained auditors and capable standards for the accounting profession will result in better disclosures by corporations in the Saudi stock markets. The CMA, as part of its supervisory power, is required to issue rules for auditing standards used by auditing firms registered with SOCPA.

9.4.1.2 Financial Analysts and Their Role in the Disclosure Process

Financial analysts have been the focus of a number of studies regarding the value of intermediaries and their role in the disclosure process. According to Healy and Palepu, the role of financial analysts is to gather information from public and private sources, evaluate the current performance of the firms that they follow, make forecasts about their future prospects, and recommend that investors buy, hold or sell the stock.\textsuperscript{1103} Leyens also says that financial analysts ‘provide a buy, hold or sell recommendation based on their estimate as to prospective stock prices of the issuer and the development of the market in whole’.\textsuperscript{1104} Financial analysts are ‘outsiders’ who generally have less access to a firm’s operations and internal documentation than ‘insiders’, such as company personnel.

Financial analysts have an important role in the disclosure process. It is admitted that having financial analysts will help reduce the level of information asymmetry by providing earnings forecasts that the assist investors to better assess a firm.\textsuperscript{1105} The role of the analyst in forecasting activity tends to ‘accelerate both industry and firm-specific

\textsuperscript{1102} Ibid 69.
\textsuperscript{1103} Healy and Palepu, above n 1096, 416.
\textsuperscript{1104} Leyens, above n 1094, 54.
\textsuperscript{1105} Al-Aqeel and Spear, above n 170, 15.
Chapter 9: Securities Regulator’s Enforcement

earnings information’. The disclosures made by financial analysts affect the stock price as well as investor investment decisions, similarly to auditors’ reports.

An empirical study found that investors in Saudi Arabia security markets have limited access to professional financial analysts. Although the Saudi securities market has the highest level of trading on private information, the lack of sophisticated financial analysts in the Saudi market is considered as a weakness of the market. What is more, the professional analysts’ community is almost entirely absent. Additionally, the rules and enforcement of illegal trading are almost absent and the penalty for breaching such rules is insignificant.

The role of the CMA in regard to the financial analysts as market intermediaries is completely absent. So without regulations governing the activities of financial analysts, the integrity of their work may be questioned. Currently, the CMA has realised the important role played by financial analysts in the securities market. This is combined with many recent calls to regulate and establish a national authority for the profession of financial analysts. For this reason, the Saudi Bureau of Experts at the Council of Ministers has proposed a draft to regulate financial analysts’ activities. It would be hoped that if financial analysts are regulated then they would attract greater confidence and grow in number, thus displacing to some extent the dependence on ‘private information’.

1107 Al-Aqeel and Spear, above n 170, 16.
1108 Ibid 29.
9.4.1.3 Rating Agencies

The Credit Rating Agencies (CRAs) perform an important intermediary function in the global financial markets, including the Saudi stock market.\(^{1110}\) Although CRAs do not operate in Saudi Arabia, they have an influence on the stock market. Investors across the world look to credit ratings agencies to judge where to ‘place their bets’ in the market. An organisation is needed to provide investors with an independent analysis of credit worthiness, the ability to pay off loans or investments of companies, countries and financial products.

The function of credit rating agencies is to ‘rate’ investment and credit instruments to make it easier for non-specialist investors to determine the risk inherent to particular investments.\(^{1111}\) The rating agency performs a preliminary analysis of the issuer’s public financial information, including a registration statement, a prospectus, the most recent annual or quarterly report, annual reports from the past five years, and subsequent quarterly financial statements.\(^{1112}\)

IOSCO emphasises the importance of regulating market intermediaries. Principle 29 of the IOSCO Objectives and Principles states that ‘[r]egulation should provide for minimum entry standards for market intermediaries’.\(^{1113}\) Additionally, Principle 32 provides responsibility for market intermediaries by affirming that ‘[t]here should be

\(^{1110}\) The main three CRAs in the global financial market are: Standard & Poor’s (S&P); Moody’s Investors Service (Moody’s); and Fitch Ratings (Fitch).

\(^{1111}\) The four highest rating categories are from AAA to BBB, and are referred to as ‘investment grade’, while any investment instrument ranked below BBB will be classified as ‘speculative grade’ or ‘junk’. See Claire A Hill, ‘Regulating the Rating Agencies’ (2004) 82 Washington University Law Quarterly 43, 48.


\(^{1113}\) IOSCO, ‘Objectives and Principles of Securities Regulation-2010’, above n 18, 11.
procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.¹¹¹⁴

IOSCO stated four principles regarding the activities of the CRAs so that they can to be a useful tool for securities regulators. The four principles are: quality and integrity in the rating process; independence and conflicts of interest; transparency and timeliness of ratings disclosure; and confidential information.¹¹¹⁵ Additionally, it was established that the regulator should strive to achieve these principles in order to improve investor protection and the fairness, efficiency and transparency of securities markets and to reduce systemic risk.¹¹¹⁶

Although the CMA has the power to regulate rating companies, regulation for credit rating agencies is absent so far (as to December 2012). Article 6(15) of the CML’03 states that the CMA shall have the power to ‘prepare the regulations and rules for the surveillance and supervision of entities subject to the provisions of this Law’. In addition, art 6(18) gives the CMA the power to ‘grant the necessary licenses to be issued in accordance with the provisions of this Law and its Implementing Regulations, including the licensing of rating companies and agencies and the conditions thereof’. It may be the case that the absence of regulations to govern CRAs has a negative effect on the Saudi securities market. Hence, it can be stated that issuing regulations for the rating agencies will come as a step toward supporting legislative requirements to strengthen financial market in Saudi Arabia.

¹¹¹⁴ Ibid.
In fact, developed countries have taken practical steps toward regulating the activities of CRAs. For instance, by 2003, the need for regulation of credit rating agencies in the US had become imperative after the famous collapses of a number of giant financial institutions, such as Enron. Hence, the US Securities and Exchange Commission (SEC) realised the importance of having an adequate regulation of the credit rating activities. In 2005, the SEC recognised CRAs as Nationally Recognised Statistical Ratings Organisations (NRSROs). The largest users of credit ratings generally accept the NRSRO in the financial markets as an issuer of credible and reliable ratings.

Moreover, in 2004, the European Commission (EC) realised the need for legislation to deal with the regulation and conduct of CRAs. The EC was required to remain in close contact with other securities regulators and IOSCO to ensure that developments in credit rating services are globally consistent. In Australia, the Corporation Act 2001 (Cth) recognises credit rating as a ‘financial product advice’ under s 766B(1). In addition, ss 911A and 912A provide requirements for financial product licensing (and exemptions). However, the Australian Securities and Investments Commission (ASIC) is entitled to monitor the credit rating businesses to see whether they adhere to the IOSCO code.

The Saudi market crash of 2006 and the international stock market failure of 2008 have underlined the importance of the regulation of financial markets intermediaries. It is submitted that the role of the CMA is weak in respect of regulations regulating

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1118 Ibid 6.
1119 Ibid.
intermediaries. The above discussion regarding the absence of regulations governing the activities of the CRAs demonstrates the need for such regulation. Effective regulations that reduce risk and protect investors are vital to restore investor confidence in stock market investment.

Consequently, an effective regulatory role will provide the underpinning for market integrity and transparency and thus reduce the risks associated with financial information. As a result, the regulator will achieve the goal of having strong and effective protection for the investors.

9.4.2 Inefficient Regulatory Role of the CMA in Regard to Self-Regulatory Power

‘Self-Regulatory Organisation’ (SRO) is a general term that refers to ‘the devolution of authority from a first-level regulator to a second-level regulator, essentially relying on industry expertise’. Self-regulation is an important part of the regulatory structure of securities markets in many developing, as well as developed, economies. According to Principle 9 of the IOSCO Objectives and Principles:

Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

Carson affirms that the use of self-regulation and of SROs can:

i. improve the effectiveness of securities regulation and market integrity;

\[\text{\textsuperscript{1121}}\text{ Condon, Anand and Sarra, above n 237, 151.}\]
\[\text{\textsuperscript{1122}}\text{ Carson, above n 328, 6.}\]
\[\text{\textsuperscript{1123}}\text{ IOSCO, 'Objectives and Principles of Securities Regulation-2010', above n 18, 5.}\]
\[\text{\textsuperscript{1124}}\text{ Carson, above n 328, 1.}\]
lead to more efficient capital markets, thus enabling businesses to tap public equity and debt markets for capital at a reasonable cost, which supports business expansion and economic development.

In Saudi Arabia, there are no SROs, as the SSE does not exercise regulatory powers, although it is responsible for operationally running the market and the Depository. As mentioned earlier, the SSE can propose rules and standards in order to carry out trading in securities in Saudi Arabia. These proposals are to be submitted to the CMA for approval. Moreover, an SRO has not been defined in Saudi Arabia. By contrast in Canada, for example, an SRO is specifically defined as ‘an entity that is organised for the purpose of regulating the operations and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest’. Carson observes that ‘[m]any countries, however, do not formally define a self-regulatory organisation in law, usually because the law covers approval of an exchange, which is the only form of SROs in most countries’. On the other hand, developed countries have more than one form of SRO. For example, greater consolidation of the SRO system has been achieved in Canada. There the term SRO applies to organisations such as the Investment Industry Regulatory Organisation of Canada (IIROC).

1125 The Saudi Stock Exchange (SSE) shall submit to the CMA the regulations, rules and instructions for the operation of the Exchange and the amendments. See art 23(b) of the Capital Market Law 2003 (Saudi Arabia).
1127 Carson, above n 328.
1128 The IIROC oversees all investment dealers and trading activity on debt and equity marketplaces through setting and enforcement rules regarding the proficiency, business and financial conduct of dealer
Chapter 9: Securities Regulator’s Enforcement

The UK provides a good example of self-regulation in the field of regulating takeover bids. The UK Panel on Takeovers and Merger is an independent, private sector body that sets the UK’s Takeover Code and regulates takeover bids by applying the code.

SROs usually have responsibilities to investors, issuers, and the public imposed on them by law or regulation, and they are accountable to their supervising regulator. SROs are broadly accountable to the investors in the capital markets, not just to their members or shareholders. Those responsibilities require the SRO to: ensure compliance with its rules and, in some cases, securities regulations; protect market integrity and investors by imposing rules on business conduct; and maintain a fair, efficient, and reputable public market.\(^{1129}\)

Consequently, implementing SROs is imperative in order to regulate the market in line with the government regulator (the SSE) as the SROs cannot perform a listings role and have some responsibility for listed company disclosure or corporate governance. It is believed that ‘[a] legal framework should clearly establish the scope of an SRO’s responsibilities and the division of responsibilities between the SRO and its supervising regulator’.\(^{1130}\) In most developed jurisdictions, self-regulatory organisations, such as exchanges and industry associations, carry out part of the regulatory function in the jurisdiction. In many cases, SROs take on a significant role.\(^{1131}\)

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\(^{1129}\) Carson, above n 328, 40.

\(^{1130}\) Ibid 41.

9.4.3 Need for Reforms in the Regulatory Role of the CMA in Regard to the Disclosure Regime

In the Saudi securities market, a ‘disclosure regime’ remains a nascent concept. Although, as described above, there have been disclosure requirements put in place, the market still suffers from weak transparency and a lack of proper disclosure practice by listed companies. The regulatory role of the CMA in relation to the disclosure regime is insufficient. Hence, updating rules and regulations has become a priority in order to restore investor confidence in the market and foster investor protection. It is argued that the recent developments in corporate law governing disclosure are not effective in respect of the protection of investors. This argument may be true due to the continuous need for issuing more disclosure rules, as well as updating the current rules and regulations.

It is recognised that accurate information is the lifeblood of the securities market, and the main mission of the regulator is to safeguard the market’s ‘blood supply’.\textsuperscript{1132} The regulatory framework should ensure that the regulator has sufficient power and resources to effectively regulate and supervise the market participants. Certainly, disclosure rules and requirements are very important to the integrity of the share market.

Eastbrook and Fischel found that the broad disclosure rules are very effective in reducing risk in exchange for minor alterations of firms’ disclosures.\textsuperscript{1133} Moreover, Principle 4 of the IOSCO Objectives and Principles states that ‘the Regulator should adopt clear and consistent regulatory processes’. Thus, the regulator is required to have a defined and effective policy regarding the disclosure regime. In the US, it was agreed that the effective use of regulatory power by the SEC creates many forms of disclosure

\textsuperscript{1132} See Condon, Anand and Sarra, above n 237, 202.
\textsuperscript{1133} Easterbrook and Fischel, above n 559.
appropriate to the size of the firms and the industries in which they operate.\textsuperscript{1134} Conversely, there have been widespread allegations against the securities regulator in Saudi Arabia, claiming that the CMA has not been effective in its role in regard to the disclosure regime. In particular, there is a need for reviewing and updating the current rules and regulations of the disclosure regime.

In fact, the CML’03 has granted the CMA a wide range of powers, including the power to issue and amend the rules and regulations of the market. In addition, the CMA has a statutory power to regulate and monitor the full disclosure of information.\textsuperscript{1135} However, the use of this legal power has not been effective. For example, the crash of the Saudi stock market in 2006 was widely blamed on the lack of investor protection and regulation became a major political issue.\textsuperscript{1136} Moreover, a recent assessment of the Saudi stock market conducted in 2008 found that the disclosure regime governing the review, approval, and disclosure of related party transactions is underdeveloped.\textsuperscript{1137} As a consequence, the report presented two suggestions, namely: the CMA should review and update its rules and regulations; and strengthen cooperation with the stock market participants, such as companies, shareholders and outside experts.\textsuperscript{1138} Another study found that greater transparency and better protection for investors, as well as enforcement of sound corporate governance standards, would help reduce speculation and free investors to base their actions on market fundamentals.\textsuperscript{1139}

\textsuperscript{1134} Ibid 701.
\textsuperscript{1135} Capital Market Law 2003 (Saudi Arabia) art 5(a)(6).
\textsuperscript{1138} Ibid 8.
\textsuperscript{1139} De Boer and Turner, above n 1093, 117.
A significant issue is that the administrative enforcement of the disclosure regime has been ineffective. This situation will have negative effects on the civil liability for defective corporate disclosure and it militates against the protection of investors at large.

Based on the above, it can be said that a weak regulatory framework will contribute to hindering the protection of investors in securities markets. Thus, the need to improve the disclosure rules and regulations is fundamental for the stronger protection of investors in Saudi Arabia. Schooner and Taylor state that ‘[r]egulatory modernisation is the process of reforming the organisation and practices of financial regulation to mirror the economic realities of today’s financial services sector’.

The regulatory systems should be in conformity with regulatory objectives so the protection of investors, as the ultimate objective of the securities regulations, can be achieved.

9.5 Importance of the Regulator’s Role in Enforcing Securities Laws

In order to discuss the importance of the regulatory body acting in the interest of investors, there is a need to understand that the regulator’s role is significant. For that reason, the following will discuss the theory of public enforcement, the need for effective administration for the disclosure regime, and qualifications of members of the CMA.

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9.5.1 Theory of Public Enforcement of Securities Laws

Public enforcement of law refers to the use of government agents to detect and to impose appropriate sanctions on those who violate legal rules. The administrative enforcement in securities laws derives from the theory of the administrative process. The theory states that there are three important aspects of administrative law enforcement: the investigatory power; the adjudicatory power; and the administrative sanctioning power. The power to make orders and impose sanctions on market participants has become a major component in the enforcement arsenal of securities regulators. In addition, in the US and Canada, monetary fines have become an increasingly high-profile component of the regulatory landscape. Civil liabilities are found to be useful for protecting investors’ rights.

In order to exercise the public enforcement function, the regulator’s power to bring civil suits on behalf of investors is an effective administrative enforcement tool. In this respect, the US court in *Securities & Exchange Commission v Rind* held that civil enforcement claims are brought by the SEC to protect the public interest by ensuring the integrity and fairness of the capital markets. In Australia, the High Court upheld the ASIC verdict, which had been decided by New South Wales Supreme Court in favour of ASIC’s civil penalty claim in regard to the defective disclosures by the non-executive

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1143 Condon, Anand and Sarra, above n 237, 687.
1144 Ibid.
1145 Case Note, 'Civil Liability under the Federal Securities Act' (1940) 50 *Yale Law Journal* 90, 106.
1146 991 F2d 1486 (9th Cir, 1993); Low, above n 778, 232.
directors and general counsel/company secretary who breached their duty of care and diligence requirements.\textsuperscript{1147} Generally, ASIC uses this power only where private remedies are not practically open to those who suffered the loss. Thus, it is clear that regulatory enforcement has a larger role in respect of protecting the public from the unfair and illegal practices arising from the market than is currently the case in Saudi Arabia.

Furthermore, another role of public enforcement is to prevent the violations, not to penalise the violator. Nicholls claims that there is a theoretical distinction between the regulator’s sanctions, based on its powers to protect the public interest, and fines and other penalties levied by a court. The securities commission’s public interest powers derive from its role as a market regulator and may only be used for remedial, not punitive, purposes.\textsuperscript{1148}

Arguably, it is often said that what can be the best for investors’ interest is that the regulator uses its power to sue on behalf of investors, or where the investors are able to take action by themselves. A newspaper report of a barrister lodging written submissions in relation to a well-known accounting company involved in a number of disputes with ASIC (and retained by that company) noted that ‘[t]here was not necessarily any correlation between any amount recovered by ASIC and the amount the company would have recovered if it had conducted the case itself’, and indeed had challenged the constitutionality of the regulator’s ability to take particular actions in

\textsuperscript{1147} This case is known as the James Hardie Case. See \textit{Australian Securities and Investments Commission v Macdonald} (No 11) [2009] 11 NSWSC 287; \textit{Australian Securities and Investments Commission v Hellicar} (2012) HCA 17.

\textsuperscript{1148} Nicholls, above n 617, 381. See also the case of \textit{Committee for Equal Treatment of Asbestos Minority Shareholders v Ontario Securities Commission} (2001) 2 SCR 132.
relation to the case ‘without just terms’. 1149 According to the report, ASIC’s decisions while running the case could leave the company worse off and, according to the company’s barrister, ‘no terms — just or otherwise — are provided for such loss.…’ 1150 In the same vein, La Porta, Lopez-de-Silanes, and Shleifer have undertaken an empirical analysis, making a critical but somewhat provocative proposition that ‘securities laws “facilitating” private enforcement, rather than providing for public enforcement, benefit the securities market’. 1151 In the same article, they claim that private litigation is a more effective regulatory tool in securities markets than public enforcement. 1152

On the other hand, the fact that public enforcement has a significant role in providing protection to investors and stabilising the financial market cannot be denied. Hence, despite a number of securities scholars putting forward the proposition that private enforcement outperforms public enforcement in encouraging the growth of securities markets, 1153 the latest evidence nevertheless shows that ‘public enforcement typically dominates private enforcement’. 1154

Furthermore, public enforcement has a higher contribution to facilitating private enforcement after the regulator takes action against a wrongdoer. In this respect, the situation in Saudi Arabia requires reform. There is a call to publish decisions of cases

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1150 Ibid. It was to say the least ‘an unusual response’ (as the article also notes) on behalf of the accounting firm whose actions in relation to the company in question had given rise to the prosecutions. The case to which reference appears to be made is the Westpoint Case.
1151 La Porta, Lopez-De-Silanes and Shleifer, above n 4, 28.
1152 Ibid.
1153 Rafael La Porta et al, ‘Law and Finance’ above n 779, 1151.
1154 Jackson and Roe, above n 675.
that have been brought before the court by the CMA.\footnote{Althanyan, ‘The Announcement of the CMA Regarding the Right of Victims to Sue Is Inadequate’, above n 1028.} It is generally believed that the publication of the public enforcement of cases would facilitate private enforcement because aggrieved investors would then recognise the offenders and sue them for the loss or damage that they have sustained. Hence, investors could claim civil liability based on public action taken by the CMA against offenders who have been convicted by the CRSD of a criminal breach of the CML’03 and rules and regulation of the market. Cox et al believe that private lawsuits are more effective \textit{after} regulatory authorities have acted.\footnote{James D Cox, Randall S Thomas and Dana Kiku, ‘SEC Enforcement Heuristics: An Empirical Inquiry’ (2003) 53(2) \textit{Duke Law Journal} 737, 762.} Hence, private lawsuits are more likely to succeed given that the initial prosecution has been state funded and wrongdoing demonstrated – and the private prosecution then has an easier and therefore less costly case to run overall to the aggrieved investors.

9.5.2 \textbf{Need for an Efficient Regulatory Body for the Securities Market in Saudi Arabia by the CMA}

As shown above, weaknesses in the current regulatory body impede the goals of enforcement of the disclosure regime. Although the CMA is functionally independent from political interference, it lacks expertise in its operational area. It is argued that a regulator who lacks expertise cannot adequately enforce the securities law, whereas the efficient enforcement of law is vital for the reliability of securities markets.\footnote{Modigliani and Perotti, above n 1041, 521.} The International Organisation of Securities Commission (IOSCO) recommends that ‘Securities Commissions must be technical, specified entities specialising in their own
scope, that is, the securities market. Black asserts the need for a specialised securities regulator to pursue complex securities disclosure cases.

Baamir declares that the weak intervention by the CMA to control the market shows its lack of regulatory experience in enforcing the law. He believes that the late intervention by the CMA has been considered a significant impediment for protecting investors from corporate debacles. Before the 2006 collapse, the CMA failed to effectively intervene to control the mass speculation that had led to massive volatility in the capital market and caused losses to the general investor. For example, before the market collapsed in 2006, it was noted that the prices of shares traded by 70 companies of the 81 listed firms traded in the SSE were overpriced and the value of some losing companies’ shares went up by 200 per cent in a month — clearly unsustainable and unrelated to the actual performance of the companies in question. Hence, it can be said that the judicious use of a trading halt by the regulator is imperative to protect shareholders. A number of studies have found that market volatility is significantly lower in the reopening period than before the trading halt, suggesting that the imposition of a trading halt has been successful. A recent IOSCO report concludes that a trading halt is a useful tool to be used by the regulator in order to protect investors in the emerging markets. In another study, it has been found that the imposition of

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1158 Development Committee of IOSCO, 'The Role of Securities Commissions ' (International Organization of Securities Commission, September 1990) 5.
1161 Ibid 76. The Saudi Stock market appreciated by over 60% in 2003 and the total market cap exceeded 80% of GDP (SAR 565 billion). See Taher, above n 245, 13.
trading halts helps the dissemination of information across the market, thus enhancing the price discovery process.\textsuperscript{1164}

In respect of the CMA, although the CML’03 grants the CMA the power to halt trading in the market when it is necessary to protect investors,\textsuperscript{1165} halting trading has never been used to stop the market’s extreme volatility. Thus, it can be said that the massive collapse of 2006 and the market recession in 2008 were mainly due to the CMA’s lack of experience in enforcing the securities laws. A Saudi economist criticises the CMA’s lack of experience in supervising the market by stating that:

\ldots in inexplicably, the governmental authorities remained passive and stood by, watching this painful economic catastrophe without attempting to intervene and halt the collapse in an effort to save the country and its citizens from its destructive consequences.\textsuperscript{1166}

The importance of an effective enforcement of securities laws is stressed by IOSCO in its recent evaluation report of the global financial crisis of 2008, especially, in emerging markets.\textsuperscript{1167} The report asserted that ‘prompt and consistent enforcement action is undoubtedly one of the key criteria for building fair, efficient and transparent markets’.\textsuperscript{1168} This is not only true of emerging markets. In the US, it is believed that the serious lack of regulatory enforcement played a key role in the period preceding the recent financial crisis.\textsuperscript{1169} Furthermore, whilst there is no doubt that the securities regulation in Australia is more robust than that in Saudi Arabia, Tomasic notes that

\begin{footnotesize}
\begin{enumerate}
\item[1165] Capital Market Law 2003 (Saudi Arabia) art 6(a)(5).
\item[1166] Al-Nwaisir, `Saudi Stock Market Needs to be Reformed', above n 14.
\item[1168] Ibid.
\end{enumerate}
\end{footnotesize}
Chapter 9: Securities Regulator’s Enforcement

regulatory actions have to ‘become more creative and broadly based so as to draw more effectively upon the strength of the regulated as well as the regulator’.\textsuperscript{1170}

It has been observed that the success of the financial markets in the UK is due to strong tradition of law enforcement.\textsuperscript{1171} The effective enforcement of corporate laws will ‘support the broader objectives of market confidence and stability’.\textsuperscript{1172} The current situation in Saudi Arabia is that the regulator must be effective in order to have a successful enforcement program. It can therefore be said that despite having efficient regulations, the lack of the CML’s experience in supervising the market may undermine the enforcement of securities regulations in general. Thus the administrative enforcement of a disclosure regime will be also weakened as long as the entire enforcement by the regulator is ineffective in protecting the general investors from illegal practices in the primary and secondary share market. Hence, it can be confidently said that effective enforcement machinery is important, for without enforcement no regulatory system achieves its goals. Therefore, in order to restore investor confidence in the securities market, the regulator is required to provide adequate protection to investors. The CMA should endeavour to not only issue rules and regulations but also to effectively implement these laws ‘on the ground’. The Canadian Securities Administrators (CSA) suggests that ‘[a]n effective regulatory enforcement regime is rooted in strategies that focus on investor protection and the prevention of harm’.\textsuperscript{1173}

In reality, having a successful administrative enforcement program will not only improve investor protection, but also benefit the overall capital market. As shown

\textsuperscript{1171} Modigliani and Perotti, above n 1041, 523.
above, the effective enforcement of securities laws is vital to restore public confidence in the capital market and make investment in shares desirable. As a result, effective enforcement will lead to the investing of more funds into the capital market and, positively, the performance of the listed companies will be enhanced. Making funds available to companies will assist them to carry out their projects properly and to have better and more profitable outcomes. A recent empirical study on EU countries shows that countries with stricter implementation and enforcement experience significantly larger ‘capital market’ effect.  

9.5.2.1 Need for Reforms

Although the CMA is the sole regulator of the stock market in Saudi Arabia and has been since it inception in 2004, its lack of experience in regulating the market continues to affect its activities. It can be said that cooperation with other public and private agencies, such as the Ministry of Justice, banking sector and investment sector, is imperative for it to achieve stronger protection for the investors in the Saudi securities market. IOSCO emphasises that effective enforcement requires the regulator to have close cooperation between domestic agencies, including banking and other financial sectors.  

Furthermore, effective market regulation requires proper investigation to be conducted by the regulator. Investigation is a vital stage in the administrative enforcement mechanism. Thus, the regulator must have sufficient legal authority to investigate and to bring actions. With this in mind, regulator cooperation with governmental institutions

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1174 Christensen, Hail and Leuz, above n 249, 5.
1175 IOSCO, ‘Objectives and Principles of Securities Regulation-2010’, above n 18, 7. Principles 13, 14 and 15 require the securities regulator to cooperate with domestic and foreign counterpart authorities in information and regulation.
and agencies to obtain information in the investigation stage is essential for successful enforcement. A recent study has stressed that:

[T]he regulator should have mechanisms to obtain such information either directly or through other authorities, subject, of course, to due-process protections. In the latter case, it is particularly important that there be mechanisms in place (such as memoranda of understanding) to ensure effective and efficient cooperation from the other authority (for example, the securities regulator commonly needs cooperation of the banking regulator). There should also be mechanisms to enforce such power, including sanctions for noncompliance and for providing false information.1176

The current situation in Saudi Arabia is that the CMA is weak in terms of cooperation with other regulated agencies. Baamir states that ‘the CMA should coordinate with the Ministry of Justice to enforce its disciplinary actions against market abusers’.1177 He also points out that cooperation with the Saudi Arabian Monetary Agency (SAMA) as the banking regulator is essential to enable the CMA to access bank records.1178

It has been noted that the fines or administrative penalties imposed for breach of the disclosure regime may not create sufficient deterrence. It may be the case that the existence of only low monetary fines, as opposed to the high capital resources of listed companies, does not serve to prevent them from violating the disclosure regime. In contrast, in the UK, the FSA is authorised to levy unlimited fines on wrongdoers, so there is no maximum stipulated for fines imposed by the regulator. Davies encourages the regulator to increase the financial penalties. He explains that the reason for this is that ‘to achieve credible deterrence, wrongdoers must not only realise that they face a real and tangible risk of being held to account, but must also expect a significant

1178 Ibid.
penalty'. Considering the high value of the listed companies and the considerable profit they gain from failing to adhere to the disclosure regime and other requirements, the value of fines imposed must to be increased in order to create stronger deterrence and therefore increase the likelihood of companies complying with the disclosure requirement. It is vital that strong administrative penalties be introduced to provide more protection for investors and so induce them to invest in the capital market.

Arguably, it may be said that a tougher civil liability regime will discourage companies from going public. However, evidence counter to this argument has been found in the US. It is believed that the US has the toughest administrative enforcement of securities laws in the world. Because of that, many foreign companies claim that the US enforcement system is the most important reason for their not wanting to be listed in the US market. Langevoort, however, believes that the SEC is a highly successful administrative agency; and refers to its success in focusing on investor protection and views it as a positive. Consequently, it can be seen that, on balance, investor protection must be the purpose of any reforms that would be made to administrative enforcement in Saudi Arabia.

### 9.5.3 Qualifications of Members of the Capital Market Authority

In today’s worldwide competitive securities markets, only orderly markets can sustain developments and attract domestic and foreign investors. The effectiveness of regulation relies on the competence of the persons entrusted with regulatory responsibilities. Principle 3 of the IOSCO Objectives and Principles of Securities

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1181 Ibid.
Chapter 9: Securities Regulator’s Enforcement

Regulation provides that ‘[t]he regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers’.\textsuperscript{1182} In the interpretation of this principle, IOSCO stresses that regulator is required to have ‘experienced staff who have skills that are valuable to the private sector’.\textsuperscript{1183} In addition, IOSCO stipulates that ‘[t]he regulator must ensure that its staff receive ongoing training as required’. Based on the IOSCO Principles, sufficient training and adequate experience are very important requisites to be acquired by securities regulators for them to be effective in dealing with issues related to securities.

9.5.3.1 Professional Experience

The existence of highly qualified expert administrators is significant in respect of securities regulation. The regulator is required to have expertise in the field of the private sector and especially the securities markets. Securities regulators are charged with market supervision. Therefore, it can be said that regulatory body members with poor experience in the private sector will negatively affect the regulation of the market. For instance, a lack of accounting expertise among commissioners weakened the US regulator.\textsuperscript{1184}

As was mentioned earlier, the SEC is believed to be one of the most successful securities regulators in the world. The fundamental philosophy underpinning appointments to the SEC is that the appointee should have practical knowledge of the complicated issues involved in the securities markets. Speaking in the context of the desirability of a single equity market, a former SEC commissioner observed that a

\textsuperscript{1182} IOSCO, ‘Objectives and Principles of Securities Regulation-2010’, above n 18, 4.
\textsuperscript{1183} IOSCO, ‘Objectives and Principles of Securities Regulation-2003’, above n 253, 10.
Chapter 9: Securities Regulator’s Enforcement

‘flexible regulator that could deal directly with the markets and financial intermediaries could provide more appropriate and better oversight’;\textsuperscript{1185} many, however, are convinced that such flexibility is only able to be constructed and maintained by those with experience in the industries that their respective regulatory bodies are bound to regulate. Bosch, an experienced securities regulator, is convinced that ‘regulation of business is something that should be done for business and as much as possible by business’\textsuperscript{1186} Members with wide experience in business and practical experience of the market are reasonably expected to play an active role in improving the securities regulations.

In spite of the statutory requirement in Saudi Arabia, which states that the BCMA be comprised of five members who shall be ‘professionally qualified’,\textsuperscript{1187} the members of the Board are lacking significant practical experience in the private sector. Since the inception of the CMA in 2004, there has never been a member of the CMA from the professionals in the private sector. Rather, the composition of the members of the CMA is comprised of bureaucrats, academics and former government agency members. Therefore, market administration has been hampered by such a lack of experience and expertise and it could be said that this has contributed to its lack of success in addressing the market problems and restoring public confidence. Mann claims that a successful regulator is aware of and maintains the balance between ‘the bureaucrat’s

\textsuperscript{1185} Roberta S Karmel, ‘The Case for a European Securities Commission’ (1999) 38 Columbia Journal of Transnational Law 9, 34. She was a member of the SEC from 1977 to 1980.
\textsuperscript{1186} Henry Bosch, The Workings of a Watchdog (William Heinemann Australia, 1990) 12. He was the chairman of the National Companies and Securities Commission (NCSC), Australia, from 1985 to 1990. (The NCSC was replaced by the Australian Securities Commission in 1991, later ASIC (in 1998)).
\textsuperscript{1187} Capital Market Law 2003 (Saudi Arabia) art 7(a).
inclination to regulate everything and the financier’s preference for minimal governmental intervention’. 1188

In regard to the situation in Saudi Arabia, the first chairperson of the CMA was a bureaucrat who lacked practical knowledge and experience in securities matters as well as in the private sector. He had held different positions in a number of government agencies. He was widely criticised by the public during the major market collapse in February 2006, although he himself blamed wealthy speculators who dominated the SSE. He was discharged him from the CMA’s top position in May 2006. 1189

In many countries, it has been a requirement for members of the regulatory body to have professional experience from the private sector. The appointment of private sector professionals is evident in Australia. Prior to joining ASIC, Mr Greg Medcraft, the current chairman, spent nearly 30 years in private sector. 1190 A recent report released by the ASIC report declares that:

The Treasurer may nominate as Commissioners only people who are qualified by knowledge of, or experience in, business administration of companies, financial markets, financial products, and financial services, law, economics or accounting. 1191

In Canada, those charged with appointing a new member of the Ontario Securities Commission (OSC) must consider specialised knowledge and private sector

1191 Ibid 68.
experience. At present, 9 members of the 13 members of the OSC have extensive experience in the private sector. Consequently, it can be said that adequate knowledge and experience in the private sector, business and securities trading, are vital in order to broaden capital market efficiency. Hence, the professional experience of potential members of the CMA needs to be considered in order to bring such expertise to the regulator and there have it utilised.

9.5.3.2 Legal Education

Considering the complex nature of the securities laws, legal knowledge is crucial for a capable securities regulator. Hence, qualified persons with law degrees need to be taken into consideration in the appointment of the members of any securities regulator. The administration of the securities market requires members who have knowledge and practical experience in the legal profession. As a result, legal expertise will improve the performance of the securities watchdog in terms of the regulatory and adjudicative roles.

To demonstrate the above, the regulatory body in developed countries realised the need for members who have law degrees. In the US, all members of the SEC, including the

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1193 For example,
- Ms Margot C Howard, chartered financial analyst, foundation and pension fund portfolio manager;
- Ms Sarah B Kavanagh, investment banker and had also held senior finance positions at several Canadian corporations;
- Ms Paulette L Kennedy, financial reporting, senior management positions at Ford Motor Company (Canada) as well as a major insurer and other companies;
- Ms Judith N Robertson, international financial services (both buy and sell) and former CEO of company that is a provider of integrated trading technology and brokerage services.

See Ontario Securities Commission, Members of the Commission (11 December 2012) <http://www.osc.gov.on.ca/en/About_members_index.htm> There are also among the current OSC: three QCs, a former judge, auditors, directors with extensive experience and experienced corporate lawyers, corporate officers, and so on, amongst the 9–15 (currently 13) member OSC.
chairman, have a law degree as at December 2012. The New Zealand Securities Commission requires that ‘at least one member must be a barrister or solicitor of not less than seven years’ practice’. In the UK, amongst the members of the FSA before its recent restructure was a member who spent 20 years in private practice, specialising in commercial litigation with emphasis on financial services. Another member has a Juris Doctor degree and had had extensive legal knowledge and experience.

In Canada, 8 of the 13 members of the Ontario Securities Commission, including the chairman, have law degrees and sufficient legal experience as in 2012. In Australia, the deputy chair of the ASIC has law degrees and extensive knowledge of corporate and securities law.

In Saudi Arabia, despite the regulatory role of the CMA, the chairman and members of the CMA lack legal education. Since the inception of the CMA in 2004, no person with legal qualifications has been appointed as a member of the CMA (to the best of this writer’s knowledge, as at December 2012). The first chairman, who received enormous criticism, lacked a law degree and had no experience in dealing with capital

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1194 The Securities and Exchange Commission, *Current SEC Commissioners* (27 August 2012) <http://www.sec.gov/about/commissioner.shtml>. This is also often combined with economics, maths or other degrees and long-term business and/or academic and other experience. The SEC has five members.


1196 Margaret Cole is a Board Member of the Financial Service Authority. She is a graduate in law from Cambridge and is a solicitor. See Financial Service Authority, *Margaret Cole* (8 February 2012) <http://www.fsa.gov.uk/about/who/board/cole.shtml>. Although she left the position that month when the body was restructured, she is largely accredited with ‘cracking down on insider trading’ and launching the first criminal prosecutions: Jill Treanor, ‘FSA’s Margaret Cole to Step Down’ *Guardian* (UK) 15 February 2012 <http://www.guardian.co.uk/business/2012/feb/15/fsa-margaret-cole-steps-down>.


1200 See arts 5 and 6 of the *Capital Market Law 2003* (Saudi Arabia).
Similarly, his successor and incumbent chairman of the CMA has no law degree or previous experience in securities markets or the private sector.\textsuperscript{1202} Currently, there is no any statutory requirement for a special knowledge of law as a requisite qualification for a member of the CMA. Due to the nature of the regulatory role of the CMA, it is essential that legal education become a prerequisite for (or be acquired by) the members of the CMA. In Australia, knowledge in the field of law is mentioned as one of the basic qualifications to be taken into consideration when appointing members of ASIC.\textsuperscript{1203} Having regard to the law and practice of the developed nations mentioned above, the significance of members being familiar with legal knowledge cannot be ignored. At present, even two of the five members of the Jordan Securities Commission have a law degree and practical experience in the legal field.\textsuperscript{1204} This is the case despite there being no statutory requirement for legal education.

Based on the above, it can be recommended that Saudi securities laws be amended to include legal education/experience as a requisite qualification for at least the chairman of the CMA as well as for at least one other member of the CMA.

\textsuperscript{1201} Mr Janmaz bin Abdullah Al-Suhaimi, from 2004 to 2006. He has a Bachelor and Masters degree in the field of electrical engineering.

\textsuperscript{1202} Dr Abdulrahman Al-Tuwaijri, is the current chairman of the Capital Market Authority of the Kingdom of Saudi Arabia, from 2006 to present. He holds a Bachelor’s degree and PhD degree in Economics.

\textsuperscript{1203} ‘The Minister is to nominate a person as a member only if the Minister is satisfied that the person is qualified for appointment by virtue of his or her knowledge of, or experience in, one or more of the following fields, namely: (a) business; (b) administration of companies; (c) financial markets; (d) financial products and financial services; (e) law; (f) economics; (g) accounting’: s 9(4) of the \textit{Australian Securities and Investments Act} 2001 (Cth).

\textsuperscript{1204} Deputy Chair Mansour Haddadin holds Bachelor and Masters degrees in Law as well having extensive practical experience in Law. See Jordan Securities Commission, \textit{About JSC, Board of Commissioners} (11 December 2012) <http://www.jsc.gov.jo/Public/English.aspx?Site_ID=1&Page_ID=2333>. Mrs Muna AlMufti (appointed February 2012) is also an experienced qualified lawyer.
9.5.3.3 Representatives of Market Participants

Another issue is the absence of representatives of the market participants in the composition of the CMA. In fact, experience in the corporate management is different from other experience in the private sector. ‘Representatives of market participants’ are members who have been in charge of running companies such as senior executives and board directors, whilst ‘private sector members’ are those who have practical experience in finance and economics.

Currently, there is no provision for the appointment of market participants to the regulatory body. The appointment of representatives of market participants is infrequent and not statutorily required, so of the five permanent members of the CMA, there is only one member who has been involved in corporate management.1205

In addition to having higher legal education, members of the securities regulators in the US, UK, Australia and Canada demonstrate their extensive experience in dealing with corporate management before becoming members of their respective regulatory body.1206

9.5.3.4 Structure of the Board of the Capital Market Authority

Considering the weaknesses discussed above, specific criteria for appointment to the CMA are recommended. As outlined above, professional experience as well as higher education and practical experience in law should be the basis on which to appoint new members to the regulatory body. Thus, the members of the CMA (currently five

1205 Mr Mohamed Al-Shumrani is a member of the BCMA and has participated in the management of various companies. Capital Market Authority, ‘Annual Report of 2010’, above n 750, 9.
members including the chairman) may be divided into four categories. These categories are: legal scholars specialising in securities law, private sector professionals, market participants and finally, a member who has had practical experience as solicitor in commercial litigation and capital markets issues. Sufficient background and experience in finance and economics are essential for the private sector members. Most importantly, the chairperson must be always chosen from those who have higher law degrees. At all times, when nominating a member, the importance of investor protection and capital market growth should be paramount.

9.5.4 Accountability of the Securities Regulator

In order to provide effective regulation to the market, the CMA should be completely independent from any external interference. Any member of the CMA must be a full-time member; he or she must have financial independence as well as the security of his/her membership term. Members of the CMA should not be accountable to the executive government for their decisions. In the US, once the SEC commissioners are appointed, they are not directly answerable to either the executive or the Congress for their decisions.1207

However, it is believed that a person who is entrusted with the regulatory role should act fairly, and with highest efficiency and honesty. Therefore, a system of accountability should be put in place to ensure that the regulatory body performs its function impartially and effectively. Scholz suggests that credible accountability mechanisms for the public enforcement agency will result in effective functioning.1208

1207 Mann, above n 1188, 181.
Chapter 9: Securities Regulator’s Enforcement

Principle 2 of the IOSCO Objectives and Principles relates not only to the operational independence of the regulator but also to it being accountable in the exercise of its functions and powers. IOSCO states that the accountability implies: a regulator that operates independently of sectoral interests; a system of public accountability of the regulator; and a system permitting judicial review of decisions by the regulator. 1209

Since the establishment of the CMA in 2004, there has been no judicial inquiry conducted into any member of the CMA. This is perhaps because of an absence of a statutory accountability mechanism in regard to regulatory misconduct or malpractice in Saudi Arabia.

Members of the CMA should be immune from political and commercial interference in their functions and decisions. Thus, the government executives cannot make an inquiry regarding their functions as a member of the CMA. Nevertheless as it is important to hold accountable members of the CMA, the persons entrusted with the responsibility of enforcing regulation, and discipline them if the need arose, some mechanism must be made available.

Consequently, it is suggested that a degree of judicial oversight be implemented to permit the investigation of any allegations raised against CMA members in relation to the performance of their duties. Hence, a legal action in the general court of law could be brought against the member in question by the public prosecutor. If a member is found to be guilty of misconduct, he or she may be dismissed, based on the judiciary’s decision rather than government intervention. Indeed, for a better delivery of justice, any allegations against the members of the CMA have to be dealt with by a general

1209 IOSCO, 'Objectives and Principles of Securities Regulation-2010', above n 18, 4.
court that is independent of CMA. Having an accountability mechanism for regulatory misconduct is imperative for the maintenance of public confidence in the market. The issue of the accountability of the CMA will be further discussed in this chapter under section 5.3.

9.6 Functions of the Regulator in Protecting Investors from Defective Disclosures

The aim of the administrative enforcement of securities laws is to foster efficiency in the market and to protect general investors from corporate misconduct. An effective enforcement mechanism has a major role in assisting aggrieved investors seek redress under civil liability provisions for breaches of the disclosure regime. In Saudi Arabia, however, as seen earlier, the regulatory body (CMA) is not strong or efficient enough to enforce investors’ rights of redress. As such, the CMA’s performance is not satisfactory. In this respect, two methods may be adopted to ensure better protection of the investors, namely indirect protection (pre-violation) and direct protection (post-violation).\(^\text{1210}\)

9.6.1 Indirect Protection

Indirect protection aims to prevent the violation from occurring. It is said that the regulator should give more attention to prevention of infringements of the securities law. The following discussion will investigate the measures used by the CMA to prevent violations. Indirect protection can be implemented through education of investors and regulatory intervention before the release of the disclosure document.

\(^\text{1210}\) Also see the discussions of the role of securities regulators in protecting investors in Solaiman, 'Investor Protection by Securities Regulators in the Primary Share Markets’, above n 358, 313.
9.6.1.1 Investor Education

It is believed that investment knowledge allows investors to protect themselves from the wrongdoings committed by the market participants. The ability of an investor to make a responsible investment decision is considered the cornerstone of investment in securities. Investor education empowers investors to protect themselves. Reyes observes that ‘[i]nvestors with investment education could adequately protect themselves’. 1211 Reyes also maintains that investor education can often be the last line of defence against corporate malpractices rather than the first. 1212 Fanto concludes that educated investors can easily read disclosure documents. 1213 Studies suggest that educating investors is important for those who may not even be able to understand the importance of some simpler investment decisions, such as in regard to their own pensions. 1214

More importantly, investor education plays a key role in any risk disclosure regime. 1215 A report released by the IOSCO Technical Committee considers investor education to be a significant factor in achieving the goal of investor protection. 1216 Indeed, the potential benefits of investor education for emerging market economies are

1212 Ibid.
considerable. The former chairman of the IOSCO Emerging Markets Committee argued that the difficulties facing the developing markets could be defeated through investor education programs and training seminars, as these deliver positive results for emerging markets.

In some countries, the regulator uses the statutory authority to address investor education. In the UK, the regulator has an express statutory obligation to undertake investor education efforts. In Mexico, a separate government institution is responsible for providing investor education. In Hong Kong, the establishment of an independent council has recently been proposed, as such a council is important in being responsible for ‘educating the public in financial literacy’.

In Canada, it has been recommended that greater efforts should be made by the securities regulator to educate investors about market risks and losses, and the appropriate bearing of responsibility when an investment has negative returns. The recommendation also emphasised the importance of having sufficient recourse for investor education, such as ‘providing a financial advisor to clarify the risk associated with particular investment’.

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1218 Mr Dogan Cansizlar was the chairman of the EMC in 2005. See Final Communiqué of the XXXth Annual Conference of the International Organisation of Securities Commissions (IOSCO), above n 52.
1220 Ibid.
1221 Law, above n 1215, 26.
1223 Ibid.
Chapter 9: Securities Regulator’s Enforcement

Investor education in Saudi Arabia needs to be more recognised by the regulatory body. Before the market’s major collapse in 2006, there was a complete absence of any form of investor education by the CMA. For that reason, it is strongly believed that the lack of investment knowledge by investors was one of the main factors that led to the Saudi market crash in 2006.\textsuperscript{1224} Recently, the CMA has engaged in investor education activities, having realised the importance of the knowledge of investment to the development of the market, as well as to help the CMA to achieve its goal of the protection of investors.\textsuperscript{1225}

In addition to its ongoing investor education program, the CMA is required to allocate more resources to educate the investors about the behavioural risks that they confront in the capital market. The positive outcomes of this kind of education will not only be a better understanding of investment, but also greater investor sophistication.\textsuperscript{1226} The CMA needs to design a comprehensive investor education program covering all aspects of the IPOs and to go beyond that to educate investors about trading in the secondary market.

It should be noted here that weak representation of institutional investors in the Saudi securities market was one of the most important factors that led to the collapse of the Saudi stock market in 2006. The percentage of individual investors trading directly in the Saudi securities market is the highest globally and up to 92 per cent of the market comprising direct trading transactions.\textsuperscript{1227} As a result of the individual investors who lack investment education and experience in stock trading, the market and investor may

\textsuperscript{1225} For more details regarding the CMA investor education program, see Capital Market Authority, ‘Annual Report of 2010’, above n 750, 124.
\textsuperscript{1226} Law, above n 1215, 39.
\textsuperscript{1227} Albalawi, above n 193.
be harmfully affected by selling or buying decisions which are not based on experience. Most recently, the Majlis Ash-Shura (the Consultative Council) has criticised the CMA for not adopting an effective mechanism to raise awareness amongst investors of the risks of individuals direct trading and to encourage them to make a shift to institutional trading.

Based on the above, it can be clearly seen that investor education can play a very significant role. Educating investors must be a statutory duty that is imposed on the regulator. Proper investor education will benefit investors, the market, and the regulator. It will help the market administration to achieve better protection of the market participants, which will significantly restore public confidence and contribute to market growth. Indeed, it has been found that ‘investment education can help stimulate investor confidence and help restore integrity into the capital market’. In fact, educated investors will be capable of avoiding investments in financially weak companies that may be likely to collapse at any time and result in losses to investors. As mentioned earlier, despite the fact that the CMA has a key role to provide investors with a proper education programs, sadly, this role has not yet been taken seriously as a means of strengthening investor protection in the stock market.

However, it should be mentioned that recently there have been a number of initiatives by the CMA to educate the investors. The Investor Awareness Centre, which is found on the CMA’s website, now provides brochures, definitions and media releases within

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1228 *Majlis Ash-Shura* is a legislative body that advises the King on issues that are important to the State. See Hamdallah, above n 58.

1229 Albalawi, above n 193.

1230 Reyes, above n 1211, 170.
awareness programs targeting general investors, potential investors and school students.1231

9.6.1.2 Regulator’s Intervention Prior to the Release of the Disclosure Documents

The role of the regulator in respect of disclosure in the market is crucial. Doty comments that disclosure has always been at the heart of securities regulation.1232 Fair and full disclosure by corporations is crucial for the protection of investors. In fact, the ability of general investors to protect themselves requires sufficient knowledge of investment or proper advice from professional advisors. Neither of these two requirements is satisfactory in the Saudi Arabian market. Considering the recent establishment of the CMA, its role is not only to be a regulatory body but also to contribute to the development of the capital market.

Due to the fact that general investors are not familiar with the issue of fair disclosure, the CMA should deal seriously with it. Until the investors to have sufficient knowledge and the services of financial advisors are readily available, the CMA must pursue a strong system of verifying disclosure documents before they are released to the public. It is the regulator’s role to verify the disclosure documents for a new issue of securities and documents regarding periodic and continuous disclosures. This role is derived from the major responsibility of the regulator to protect the investors from market malpractice

or misconduct. It is a statutory duty of the CMA to monitor the full disclosure of information regarding securities and their issuers.1233

9.6.1.2.1 Primary Market

In respect of the prospectus, the role of the regulator is to verify the adequacy of the prospectus content and to ensure that it satisfies the listing requirements. In Saudi Arabia, the CMA has a statutory duty to verify the prospectus before the approval.1234 Although the CMA has recently approved prospectuses for the new issuers in the market, a lack of analysis of these new prospectuses continues to persist. Considering that the Saudi market is an emerging one, the role of the CMA needs to go beyond the verification to include active investigation into whether the information contained is accurate.

In view of the objective of investor protection, the regulator should take practical steps to prevent misleading statements and omissions in the prospectus. For that reason, it is important to establish a specialised due diligence committee (DDC) to carry out comprehensive verification of every new prospectus in the IPO market in Saudi Arabia.

To have precise disclosure in prospectus, the CMA may stipulate that issuers need to verify their prospectuses using a specialised committee (the DDC), the composition of which is specified by the regulator. The issuer will be responsible for forming a committee to be comprised of representatives from company and advisors, which will report to the company’s board. Such a committee should consist of those potentially liable for a defective prospectus or a representative of each.

1234 Ibid art 43(a). It states that ‘after its review of the prospectus, the Authority shall announce its approval or rejection of the prospectus.’
Chapter 9: Securities Regulator’s Enforcement

After the DDC approves the prospectus and it has been submitted to and approved by the company board, but prior to the release of the prospectus, the regulator must also conduct a final verification. If the prospectus is found to be defective after it is made available to the public, the committee can be held liable, along with other persons who participated in the preparation of the prospectus.

In Australia, the DDC is an alternative source to ensure that the prospectus complies with the disclosure and content requirements under the Act. The verified prospectus is signed off by the company-appointed DDC and recommended to the directors of the issuer, who approve it for lodgement with ASIC.

9.6.1.2.1.1 Stop Order

As noted earlier, securities law in Saudi Arabia lacks a statutory power to issue stop orders to errant issuers. In order to wield an effective enforcement power, however, it is important that the CMA be authorised to issue a stop order to prevent funds being raised from the public by a defective prospectus that has been issued and its defect discovered only after its issue.

The stop order is effective in deterring violations in prospectuses. In Australia, a ‘stop order’ is described as an effective tool for ASIC to utilise among its enforcement strategies. Golding supports its use as a deterrent for potential defective disclosures in a prospectus. He asserts that ‘ASIC perceives that the use of stop orders is its

\[\text{1235} \] A full disclosure document or prospectus that complies with the provisions of Chapter 6D of the Corporations Act 2001 (Cth).
\[\text{1236} \] The Committee may include solicitors, investigating accountants, a broker and/or underwriter. See John Diddams, 'The IPO Due Diligence Process', Company Director (May 2002) 34 <http://www.jfdcpa.com.au/static/G/b/200c6f39b80dda8e7bb5d36c6c5b3e49.pdf>.
\[\text{1237} \] Corporations Act 2001 (Cth) s 739 states ‘where ASIC is satisfied that an offer may contravene the prohibition on prospectus misstatement, it may order that no securities issue or sale can be made while the order is in force.’
principal means of dealing with inadequate disclosure’, and adds that such a power is but ‘one aspect of the regulatory armoury to achieve an appropriate level of deterrence’.\footnote{Golding, above n 275, 202.} For instance, ASIC issued a stop order on the prospectus of a company involved in a biotech float, following a hearing that found that its prospectus was misleading and deceptive in several respects.\footnote{The stop order was issued to prevent any offers, issues, sales or transactions being made under the prospectus dated 27 April 2001. For details, see Australian Securities and Investments Commission, ‘ASIC Issues Final Stop Order on Biotech Float’ (Media Release, 01/219, 22 June 2001) <http://www.asic.gov.au/asic/asic.nsf/byheadline/01%2F219+ASIC+issues+final+stop+order+on+biotech+float?opendocument>.} It also lacked adequate information. Inadequate information being supplied prompts stop orders as this inadequacy makes it impossible for investors to make informed decisions.\footnote{See, eg, Australian Securities and Investments Commission, \textit{Lack of Information Leads to Stop Orders} Media Release, 02/175, 17 May 2002 <http://www.asic.gov.au/asic/asic.nsf/byheadline/02%2F175+Lack+of+information+leads+to+stop+orders?openDocument>. Here in the case of a Queensland-based property development company prospectus and that of a Perth-based oil and gas company.} Such an order means that trading stops immediately upon its issue.\footnote{\textit{Corporations Act 2001} (Cth) s 739.} Such a power is necessary in the Australian context because, as then ASIC director Richard Cockburn stated in 2002, unlike the Saudi regulator:

Contrary to some public perceptions, we don’t review fundraising documents before they become publicly available, nor do we pronounce judgment on the merits of a particular business enterprise. Instead, we aim to ensure that the prospectus has adequate information so that investors themselves can decide on the merits of investing in the company.

In Australia, only ‘a number of selected prospectuses’ are routinely examined in practice ‘to ensure the disclosure is adequate’ and these ‘are selected using risk criteria
developed from [ASIC’s] experiences in this area.’\textsuperscript{1243} whilst in Saudi Arabia, at least theoretically, all prospectuses are examined prior to their release. However, as noted earlier, despite this power, defects have been found in prospectuses or in the process of their issue \textit{after} they have been issued.\textsuperscript{1244} (as has also occurred in relation to subsequent disclosures then made under continuous disclosure requirements — see further below).

In the US, § 8(d) of the \textit{Securities Act 1933} (SA’33) provides the stop order power to the SEC when it appears that a registration statement\textsuperscript{1245} includes any untrue statement of a material fact or omits to include any material facts required to be stated. In contrast, because the CML’03 does not stipulate the power of a stop order, the CMA has no right to suspend the issue of a prospectus, should any error be detected post-issue. Therefore, it is suggested that a provision similar to the above US provision be inserted in the CML’03 in order to broaden the scope of the regulator’s role in protecting investors from defective prospectuses.

9.6.1.2.2 Secondary Market

Listed companies have to provide the CMA with quarterly and annual reports before disclosing them to the public.\textsuperscript{1246} According to art 45(b)(4) of the CML’03, the CMA has the power to apply additional rules and request extra information from the company

\textsuperscript{1243} Ibid.
\textsuperscript{1244} See, eg, Abdullah Albsalei, 'Integrated Telecom Company: Pressure Forced the Founders to Deposit Amounts', \textit{Aleqtisadiah} (online), 13 June 2012 <http://www.aleqt.com/2012/06/13/article_666406.pda> [Arabic]. In this example, despite the significant defects in the prospectus of the Integrated Telecom Company (ITC), the CMA approved it in April 2011. In addition, the ITC annual financial report for 2011 was defective, which made the CMA suspend trading in ITC in April 2012.
\textsuperscript{1245} The ‘Registration Statement’ is a set of documents, including a prospectus, which is filed with the SEC prior to the initial public offering.
\textsuperscript{1246} \textit{Capital Market Law 2003} (Saudi Arabia) art 45(a)–(c).
to assist investors and their advisors to make informed investment decisions.\textsuperscript{1247} Nevertheless, the role of the CMA may be considered inadequate in regard to confirming the accuracy of periodic reports to be published for the public.

It has been claimed that disclosures in periodic financial reports are inadequate.\textsuperscript{1248} For instance, companies’ periodic financial reports may have a shortfall in the information regarding the company’s plans and strategies for the future.\textsuperscript{1249} Thus, investors will not be able to make an informed investment decision and observe future company performance in terms of whether it is in accordance with the proposed plans. Criticism has extended to the role of the CMA in protecting investors from defective periodic disclosures.\textsuperscript{1250} It is a statutory duty of the CMA to require companies to disclose their reports adequately to it and to impose further instructions before the publication of these reports if required.\textsuperscript{1251}

Furthermore, the role the CMA becomes very significant in respect of continuing disclosures. Listed companies are obliged to inform the CMA of any material information changes, which may affect the price of the security. Assessing continuous disclosures by listed companies falls within the authority of the statutory function of the CMA.\textsuperscript{1252} But in practice, companies persist in releasing inadequate material information, which is not helpful to a prospective investor trying to make an informed

\textsuperscript{1247} In addition to the requirement to issue periodic reports, the CMA has the right to apply additional rules and require extra information from the listed company.
\textsuperscript{1248} Alhilali, above n 997.
\textsuperscript{1249} Most of the published financial statements concern with the past information which are not important to the investor as the ‘future information’ or future plans and predictions.
\textsuperscript{1250} Alhilali, above n 997.
\textsuperscript{1251} Capital Market Law 2003 (Saudi Arabia) art 45(b)(4).
\textsuperscript{1252} Ibid art 46.
investment decision. This is despite the statutory power given to the CMA in art 6(a)(10) to ‘[d]etermine the contents of annual and periodical financial statements, reports and documents that should be submitted by issuers offering securities for public subscription or the issuers whose Securities are listed on the Exchange’. Coffee emphasises that the failure of continuous disclosure is relevant to the actual regulation and the effectiveness of its enforcement.

Thus, it can be clearly said that the role and law of the CMA in verifying disclosure documents are inadequate. For the sake of investor protection, there is a considerable need for an effective disclosure verification mechanism to be adopted by the CMA in regard to the prospectuses, periodic reports and continuing disclosures of companies. The CMA should seriously consider adopting, in addition to its existing duties, a preventive policy (as discussed above), such as educating investors in order to enable them to assess the financial documents, and effective regulatory verification before the issuance of the disclosure documents. This would increase their own powers of detection of failures and their ability to evaluate such documents. Nevertheless, this proposal would not be workable in Saudi Arabia unless consideration was also given to educating intermediaries. In addition, the regulator should undertake a merit review to some extent on behalf of the investors. This could further complement the protection already afforded by the CMA.

Figures from a comparatively recent US study also demonstrate what is possible when investors and others in the market are themselves able to recognise problems within documents and report them to the regulator. In that study the vast majority of detections

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1254 Coffey, above n 562, 302–3.
Chapter 9: Securities Regulator’s Enforcement

were initially detected by persons other than the regulator, not only revealing the shortcomings of that regulator but also the advantage of an educated market.\(^{1255}\)

Consequently, it is believed that ‘[a]n effective regulatory enforcement regime is rooted in strategies that focus on investor protection and the prevention of harm’.\(^{1256}\) This necessarily involves, however, preventive indirect strategies and more direct protection.

In order to establish an effective role for the regulator in the protection of investors, effective enforcement in the period of post-violation is equally as important as protection prior to the violation. Thus, direct protection by the regulator is important to allow aggrieved investors (as a result of a defective disclosure) to seek remedies against the wrongdoers.

9.6.2 Direct Protection

The CMA has been mandated by the CML’03 to implement the rules and regulations relating to the market. To achieve this purpose, the CMA is empowered to penalise the violators of the disclosure regime. Direct protection aims to remedy the violation and enable injured investors to seek compensation. The regulator can also impose a fine on persons held liable for disclosure violations.\(^{1257}\) In order to impose financial penalties on the above persons, a claim of a breach requires the CMA to carry out an investigation.


\(^{1257}\) Capital Market Law 2003 (Saudi Arabia) art 59(b): ‘the CMA may impose a financial fine upon any person responsible for the violation of this Law. The fine that the Committee or the Board can impose shall not be less than SAR 10,000 and shall not exceed SAR 100,000 for each violation committed by the defendant’.
9.6.2.1 Investigative Powers of the Capital Market Authority

The concept of due process of law is to balance the rights of individuals and the authority of the law. Hence, due process of law must be observed in every dispute. This process starts with an investigation. Investigation into a securities market violation has three functions: gathering information to initiate the dispute; initiating the prosecution process and thus facilitating the conviction of the offender; and restoring public confidence regarding the effectiveness of the regulation concerned.1258

Securities markets are vulnerable to violations. Investors in the securities market expect strong and rigorous enforcement of securities laws. As a matter of necessity, the regulator should have adequate regulatory powers encompassing investigation, as well as the mechanisms in place to execute those functions.

According to IOSCO, a principle of enforcement of securities regulation is that the regulator ‘should have comprehensive inspection, investigation and surveillance powers’,1259 and ensure their ‘effective and credible use’ and the ‘implementation of an effective compliance program’.1260 Investigative powers have a crucial role in administrative enforcement. They play a central role in the enforcement, which raises the question of whether the investigative powers of the CMA are sufficient or not.

In Saudi Arabia, the CMA is required to conduct investigations in order to oversee the market and determine if a person ‘has violated or is about to violate’ the CML03 or any

1260 Principle 12: Ibid.
of its rules and regulations.\textsuperscript{1261} The CMA has the power to issue subpoenas, take evidence and inspect any record as it sees fit.\textsuperscript{1262} 

Although the CML’03 empowers the CMA to undertake an investigation, it does not give details of the procedure for carrying out this investigation. The general provision of investigation powers to the CMA is lacking in detail concerning the criminal procedures for manipulative conduct.\textsuperscript{1263} This shortcoming may complicate the right of investors to seek compensation upon a criminal conviction being recorded. Those injured by any manipulative conduct and who have not asked for compensation for damages through a criminal procedure may benefit from the conviction decision obtained to seek compensation through a civil procedure. This is because a civil suit does not have the level of burden of proof that exists in criminal suits.

Moreover, there are no clear regulatory structures for the period prior to the investigation. A similar observation has been made in relation to the SEC in the 1970s when Lowenfels noted that, ‘In the pre-investigatory stage, the Commission should issue some sort of informal guidelines to the staff with respect to recommending the initiation of investigations which would make the entire process more even-handed and

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\textsuperscript{1261} Article 5(c) of the CML’03 provides the CMA with instigative function and powers. It states that: 
For the purpose of conducting all investigations which, in the opinion of the Board, are necessary for the enforcement of the provisions of this Law and other regulations and rules issued pursuant to this Law, the members of the Authority and its employees designated by the Board are empowered to subpoena witnesses, take evidence, and require the production of any books, papers, or other documents which the Authority deems relevant or material to its investigation. The Authority shall have the power to carry out inspections of the records or any other materials, whoever the holder may be, to determine whether the person concerned has violated, or is about to violate any provision of this Law, the Implementing Regulations or the rules issued by the Authority. 
Similar to the above provision, see s 21(a)(b)(c) of the \textit{Securities Exchange Act 1934} and s 11 of the \textit{Ontario Securities Act 1990}. 
\textsuperscript{1262} Earlier in this chapter, details of the role of CMA’s Department of Enforcement have been provided. 
\textsuperscript{1263} The \textit{Capital Market Law 2003} (Saudi Arabia) does not provide the legal proceedings in criminal matters. 
\end{flushright}
predictable'. Thus, to achieve an effective investigation mechanism, the CMA must conduct the investigation process having adequate powers to do so effectively and using such powers that are provided effectively.

9.6.2.2 Need for an Effective Investigation for the Allegations of Disclosure Violations

Although the CMA has been given broad investigative tools by the CML’03, as identified earlier, the regulator is required to carry out efficient investigation of the violations that lead to market loss. Investigation and prosecution of market manipulation should continue to be imperative to ensure that businesses and small investors alike are adequately protected.

This requires that staff of the securities regulator should have sufficient knowledge and experience concerning the process of investigation, such as people with, ‘keen mathematical minds trained in finance who can keep up with new products and financial engineering models… [and] people with technological expertise’. Practical knowledge is also an important requirement for regulator staff. In Australia, according to ASIC, its Market Surveillance team is made up of a number of former ASX surveillance staff and ASIC staff with extensive market experience so as to be able to effectively identify market misconduct issues.

Chapter 9: Securities Regulator’s Enforcement

The CMA should also be granted stronger powers to impose sanctions and fines in its administrative and quasi-judicial capacity in the same way as the American Securities Exchange Act 1934 (SEA’34) and Investment Advisers Act 1940 (IAA’40) authorise the SEC’s Division of Enforcement to institute administrative proceedings and impose sanctions against persons associated with broker-dealers, municipal securities dealers, investment advisers, or investment companies.1269

However, empowering CMA alone will not help. Non-regulatory bodies/persons should also take part in process as is done in the US. For instance, in the US, a study over 216 cases of violations in the market over the period 1996 to 2004 found that only seven per cent of these cases were discovered by the SEC.1270 In the same study, it was found that most of these cases were uncovered by market analysts, auditors and investors.1271 This study shows that even in developed countries such the US, the discovery of violations requires additional resources and developed mechanisms to effectively track new violations throughout the market.

In fact, the need for ongoing development of investigative powers persists. For instance, in order to improve ASIC’s ability to police the markets and combat stock market manipulation in Australia, recent regulatory amendments1272 make additional resources

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1270 Dyck, Morse and Zingales, above n 1255.
1271 Ibid.
1272 The Corporations Amendment (Financial Markets Supervision) Act 2010 (Cth). ASIC is now responsible for the real-time monitoring of ASX’s markets and for administering and enforcing compliance with the new ASIC Market Integrity Rules (ASX Market) 2010.
available to ASIC and enhance its investigative powers.\textsuperscript{1273} Constable comments that
the deterrent effect of such a development would be considerable.\textsuperscript{1274}

\subsection*{9.6.3 Review of the Administrative Enforcement Decisions}

Remedies against the decisions of the CMA are available in Saudi Arabia.\textsuperscript{1275} The
CRSD is empowered to hear cases brought against the CMA, and to order any form of
remedy necessary to redress the rights of the aggrieved person.\textsuperscript{1276} The decisions and
sanctions issued by the CMA can be only reviewed by the CRSD. The aggrieved person
can submit a grievance against decisions issued by the CMA. The implication here is
that there is only one remedy against the decision of the CMA namely, a grievance
against such decision.\textsuperscript{1277}

Although a claim against the CMA’s decisions is available in art 25(c) of the CML’03,
it is unclear in respect to whether a person can submit a grievance directly to the CRSD
or whether it has to initially be placed in the hands of the CMA itself. In both situations,
however, a review of the particular decision can be done by the CRSD, which — some
may say — may be to a great extent under the power and influence of the CMA, whose
Board appoints the members of the CRSD.\textsuperscript{1278} In this case, a question may arise: how
effectively can the appointee take an action against the appointer? It is a conflict-of-

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\textsuperscript{1273} Constable, above n 1266, 108.\\
\textsuperscript{1274} Ibid 56.\\
\textsuperscript{1275} Article 25(c) of the \textit{Capital Market Law 2003} (Saudi Arabia) provides that:
The Committee’s jurisdiction shall include claims against decisions and actions taken by the
Authority or the Exchange and the Committee shall have the right to issue a decision awarding
damages and request to revert to the original status or issue another decision as appropriate and
that would guarantee the rights of the aggrieved.\\
\textsuperscript{1276} \textit{Capital Market Law 2003} (Saudi Arabia) art 25(c).\\
\textsuperscript{1277} The CML’03 uses the term ‘grievance’ which here means bringing a complaint against decisions.\\
\textsuperscript{1278} Article 25(b) of the \textit{Capital Market Law 2003} (Saudi Arabia) states that ‘the members of the
Committee shall be appointed by a Board decision for a three-year term renewable’.
\end{flushleft}
interest situation where justice may suffer. Therefore, it may be the case that ‘[w]ho will guard the guards themselves?’.

In Australia, a person aggrieved by an ASIC decision has the right to seek a review of the decision by the Administrative Appeals Tribunal (AAT). The AAT is an independent body that can review ASIC’s decisions which are made under s 244(2) of the Australian Securities and Investment Commission Act 2001 (Cth) (ASICA’01). The AAT can, among other things: confirm, vary, or set the ASIC decision aside and replace it with its own decision. Moreover, persons affected by the decision of ASIC can challenge the right of the regulator to begin a proceeding on behalf of the public interest. For example, the recent case of the accounting firm KPMG against the ASIC’s enforcement powers. In the High Court of Australia, KPMG challenged the constitutional validity of s 50 of the ASICA’01 on ground that ‘ASIC’s use of section 50 turned a company’s private right into an exercise of public power’. Any person who has been affected by a decision or order of ASIC can lodge a further appeal with the High Court to question the law arising out of such a decision.

In the UK, the Upper Tribunal Administrative Appeals Chamber (the Tribunal) is empowered to review decisions of the FSA. The Tribunal is an independent body

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1280 Corporations Act 2001 (Cth) s 1317B; Australian Securities and Investments Commission Act 2001 (Cth) s 244.


1282 The Upper Tribunal is called also the ‘Administrative Appeal Chamber for the United Kingdom’. It is a Superior Court of Record with UK wide jurisdiction. For more details, see Ministry of Justice (United Kingdom), Administrative Appeals Tribunal Guidance (21 August 2012) <http://www.justice.gov.uk/tribunals/aa>.
Chapter 9: Securities Regulator’s Enforcement

and part of the administrative justice system of the UK. The Tribunal may uphold, vary or cancel the FSA’s decision. In addition, any person aggrieved by a decision of the FSA can commence judicial proceedings to challenge the FSA decision. For instance, the Swift Trade Case against the FSA, among others, shows that the decision of the corporate regulator could be subject to a review by an independent judiciary.\textsuperscript{1284}

In Canada, under sub-s 9(6) or s 144 of the Securities Act 1990 (Ontario) (SA’90), a person or company affected by a decision by the OSC can apply for a judicial review with the Divisional Court of the Ontario Superior Court of Justice. These provisions allow a person or company to apply for a further decision or for a variation to or revocation of the OSC decision.\textsuperscript{1285}

Based on the above, provisions in developed countries clearly reveal the Saudi provision regarding remedies against the regulator’s decisions as inadequate. Further, it may seem to be contradictory to Principle 4 of the IOSCO Objectives and Principles regarding regulators having ‘clear and consistent … processes’, given the absence of a judicial review power. Additionally, Principle 2 of the IOSCO Objectives and Principles holds that regulators should be ‘accountable in the exercise’ of their functions and powers. Therefore, the CMA decisions should be made available for judicial scrutiny without weakening the significance of having an effective administrative enforcement.

\textsuperscript{1284} For further details, see Financial Service Authority, 'FSA Decides to Fine Firm £8m for Market Abuse' (Media Release, FSA/PN/075/2011, 31 August 2011) <http://www.fsa.gov.uk/library/communication/pr/2011/075.shtml>. In light of appeal (later withdrawn by mutual consent) the editor’s notes under the Media Release were updated 20 January 2012. In another case, a successful appeal was lodged by a UBS banker: Sarah White, 'UBS Banker Wins Appeal against FSA', Reuters (online), 23 April 2012 <http://uk.reuters.com/article/2012/04/23/uk-fsa-tribunal-pottage-idUKBRE83M0MC20120423>. In this instance the finding against the upper level executive was overturned and the fine of GBP 100,000 no longer applied, although proceedings against lower level personnel went ahead and a fine was imposed on the bank itself.

There were 17 grievance resolutions sought by persons in 2009–2010. This is in terms of 210 decisions/resolutions issued by the CMA in that period.\textsuperscript{1286} In addition, Table 9.9 (below) shows that there were eight decisions reviewed by the ACRSC and no such appeals have been finalised in the period, whereas 4 grievances have been resolved during the period.\textsuperscript{1287} Unlike the provisions of developed countries, those of Saudi Arabia do not currently allow the affected person to seek judicial review in an independent and higher court other than the CRSD. The close association between the CMA and CRSD has led to accusations that the latter is under the influence of the CMA, and therefore the affected person may be disadvantaged by a lack of alternative judicial scrutiny. This perception exists because the CRSD was established by the CMA which also appoints the members of the CRSD.\textsuperscript{1288} Hence, it has been said that allegations against the CMA — such that, the regulator misuses its statutory powers — may appear to be true.\textsuperscript{1289}

\textsuperscript{1287} These are not necessarily the same matters as a matter carried over from the previous year may be resolved during this period, while others initiated during 2009–10 are carried forward.
\textsuperscript{1288} Capital Market Law 2003 (Saudi Arabia) art 25(a) states that the CMA shall establish a committee known as the ‘Committee for the Resolution of Securities Disputes’ which shall have jurisdiction over the disputes falling under the provisions of the CML’03; and art 25(b) provides that the members of the CRSD shall be appointed by a BCMA decision for a three-year term renewable.
\textsuperscript{1289} Albsalei, ‘Legal Excesses by the CMA Lead to Investors Fleeing’, above n 927.
Table 9.9: Grievances against Decisions and Orders of the CMA in 2009 and 2010
(There were 210 Decisions issued by CMA during 2009 and 2010)

<table>
<thead>
<tr>
<th>Case Type</th>
<th>Filed in 2009 and 2010</th>
<th>Finalised in 2009 and 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Number</td>
</tr>
<tr>
<td>Grievances against the CMA Board</td>
<td>17</td>
<td>4</td>
</tr>
<tr>
<td>Resolutions/Decisions before the CRSD</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appealed before the ACRSC</td>
<td>8</td>
<td>0</td>
</tr>
</tbody>
</table>


It is consequently suggested that in addition to the presently available right to lodge a grievance in regard to BCMA resolutions or decisions, CMA decisions should be made open to judicial scrutiny. It is believed that such a suggestion will enhance credibility and accountability in the administrative enforcement of securities laws.

9.7 Summary and Conclusions

It has been submitted that enforcement of law is much more important than the quality of the law ‘on the books’.1291 Hence, effective law enforcement is a major concern for any legal system. For that reason, a securities watchdog body is required to be properly equipped with balanced powers and corresponding accountability in order to achieve the basic objectives of securities regulations. These objectives, as stated by IOSCO, are: protecting investors; ensuring that markets are fair, efficient and transparent; and reducing systemic risk.1292 Investor protection is a prime aim of the administrative enforcement of securities laws.

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1291 Pistor, Raiser and Gelfer, above n 877.
1292 IOSCO, 'Objectives and Principles of Securities Regulation-2010', above n 18.
enforcement program. Good regulatory practice has been well summarised by Fiona Haines and David Gurney who declare that it ‘focuses on the outcomes of regulatory aims, not obsessive concern about compliance with prescriptive rules.’

La Porta et al and DeFond and Hung argue that law enforcement institutions, such as market regulators, play a vital role in protecting the interests of investors and re-establishing confidence in the stock market.

An increased power for the regulator is encouraged by Xu and Pistor. They describe the court as ‘reactive’ because it enforces law only after others have brought an action. On the other hand, they describe enforcement by the regulator as a ‘proactive’, which may be better for preventing harm.

Langevoort is convinced that ‘strong enforcement and dispute resolution are the most crucial elements of global securities regulation’.

In this respect, Principle 11 of the IOSCO Objectives and Principles demands ‘comprehensive enforcement powers’ for regulators.

Although there has been improvement in the CMA structure and performance in the administration of the market, shortcomings have persisted in relation to the effectiveness of administrative enforcement. As evident in the discussion, the current

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1293 Fiona Haines and David Gurney, 'Regulatory Conflict and Regulatory Compliance: The Problems and Possibilities in Generic Models of Regulation' in Richard Johnstone and Rick Sarre (eds), Regulation: Enforcement and Compliance (Research and Public Policy Series No 57, Australian Institute of Criminology, 2004) 11.
1294 Rafael La Porta et al, 'Investor Protection and Corporate Protection', above n 19, 1170; Rafael La Porta et al, 'Investor Protection and Corporate Governance', above n 19, 28; DeFond and Hung, above n 259, 272–3.
1296 Ibid.
1298 IOSCO, 'Objectives and Principles of Securities Regulation-2010', above n 18, 6.
situation of CMA is not satisfactory for investors who sustain loss or damage due to disclosure violations.

In addition to the inefficient judicial enforcement of the securities laws as discussed in the preceding chapter, weak administrative enforcement will significantly undermine the civil liability regime for defective disclosures in Saudi Arabia. It has been found that the Saudi provisions of administrative enforcement are inefficient in contrast to their equivalent in developed countries provisions. Moreover, it has been seen that the CMA has not fulfilled the objectives and principles of IOSCO. In reality, the efficiency of the CMA has been questioned on several occasions by market observers who blamed the regulator’s functioning (or lack thereof) for the massive loss of investors who were understandably cautious in the wake of the 2006 market collapse. The lack of local investors also served as further incentive to open the market more to overseas investment in order for the local market to recover. As a result, the Saudi Arabia stock market, after the 2006 crash, started to open the market for non-residents to trade in local stocks through Saudi intermediaries.\(^\text{1299}\)

This adds further impetus to the need to bring the regulatory structures into the 21st century with appropriate powers and finely-tuned investor protections able to better handle new and existing challenges and so engender greater confidence in the market.

In this chapter, it has been found that the existing CMA’s role in enforcing the disclosure regime is inadequate. Drawbacks hindering the role of the CMA are: lack of transparency; weak interference by the CMA; weak detection and investigation; inadequate monetary fines; and lack of uniformity in the exercise of the CMA’s powers.

Chapter 9: Securities Regulator’s Enforcement

It has been found that these drawbacks resulted from the weak functions of the CMA as the sole regulator of the securities market in Saudi Arabia. In reality, the members of the CMA lack experience in the private sector, appropriate legal education and experience in dealing with corporate management.

In terms of disciplining members of the CMA, it is important to hold those persons entrusted with making regulation accountable. It has been discovered that no judicial inquiry has been conducted since the establishment of the CMA, which is perhaps due to an absence of a statutory accountability mechanism against regulatory misconduct or malpractice in Saudi Arabia.

It has been seen that the role of the CMA in controlling market malpractice is not satisfactory. This finding is an outcome of measuring the CMA’s role in protecting investors in both pre-violation and post-violation phases. In the pre-violation stage, investor education is lacking the resources necessary to educate investors about the behavioural risks, IPOs and secondary markets. Likewise, the CMA’s intervention prior the release of the disclosure document is weak. There is: an absence of clear verification process for prospectuses before they are released to the public; no clear verification of material information in the periodic and continuous disclosures; and the absence of a stop order provision under the CML’03. Moreover, it has been found that the role of the CMA in the post-violation is also inadequate. The investigation power of the CMA is inefficient regarding the procedures and prosecution of market manipulation.

Based on the above and following the path of the developed countries, a number of recommendations can be made to allow the CMA to have a more effective role in enforcing the disclosure regime. As noted earlier, the members of the CMA need to be
required to have relevant qualifications to perform their regulatory role. The current composition of the members of the CMA is inadequate in terms of legal education, professional experience and market representation. In addition, a system of accountability should be put in place to ensure the CMA performs its role impartially and effectively. Hence, a degree of judicial intervention is suggested in order to investigate into any allegations raised against the members of the CMA.

To provide a comprehensive protection for investors in the IPO and secondary market, proper investor education is needed to benefit the investors, the market, and the regulator. The CMA needs to design a comprehensive investor education program covering all aspects of IPOs and to go beyond that to educate investors about trading in the secondary market. It is highly recommended that a specialised due diligence committee (DDC) be established by companies to carry out comprehensive verification of new prospectuses. This DDC is to be composed of company persons and advisors. Rules and Composition of the DDC is to be set out by the CMA.

These recommendations extend to having an effective investigation power for the CMA joined with the appointment of experienced and trained staff. It has been submitted that it is important for the CMA to have clear procedures to conduct an investigation into any allegations of disclosure violations.

Following the path of developed countries, provisions may be inserted in the CML’03 in relation to appeals against the decisions of the CMA. Appeals may be allowed to be heard by a bench of the judiciary independent of the influence of the CMA. Furthermore, it is suggested that establishing an independent committee to observe the regulator is highly recommended in order to have an effective enforcement program.
For instance, in the US there is a call to establish a new advisory committee to conduct an independent review of the Commission’s enforcement program from multiple, diverse perspectives, and for it to recommend to the Commission, if warranted, any necessary changes. Atkins and Bradley are confident that the outcome of such a committee ‘will be an enforcement program that is more transparent, better embodies principles of due process, and more effectively combats violations of the federal securities laws’. 1300

To this end, effective regulator enforcement of securities laws is crucial for the protection of investors. In view of the disclosure requirements, it is strongly suggested that reforms are needed in order to have an effective enforcer in both the IPO and secondary markets.

To enable investors to make informed investment decisions and restrain companies from issuing defective disclosures, reforms in the regulatory regime should be brought into conformity with the proposals made in the discussions in this chapter. It is to be always remembered that securities regulators have a clearly defined mission, which is to protect investors. 1301


CHAPTER 10: MAJOR FINDINGS AND GENERAL CONCLUSIONS

10.1 Introduction

A well-functioning stock market plays a significant role in the development process in an economy. The importance of the stock markets is derived from two important factors: transforming people’s savings to be invested in a stock market and allowing for a more efficient allocation of resources. The securities market in Saudi Arabia is the biggest market in the Middle Eastern region and the fastest growing amongst the developing markets in the world. However, the main prerequisite for an efficient and developed market is to have adequate laws and appropriate regulations that are well enforced.

Most of the literature reviewed throughout the thesis show that stronger securities regulation can bring about significant economic benefits. The sustainable development of stock markets requires adequate protection of investors, and a lack of such protection keeps the investing public out of the market. Hence, an adequate civil liability regime is essential to provide protection for investors in the securities market. However, from beginning to end, it has been agreed that ‘good legal rules’ are of vital importance in all robust securities markets. However, the Saudi securities market is yet to be considered a robust market. Hence, developing securities regulation for investor protection is a useful philosophy for the integrity of the securities market in Saudi Arabia.

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1303 Johnson, above n 668, 2.
Chapter 10: Findings and Conclusions

It should be noted that this study appreciates the current strength of the market in three ways. The first is that the government has become more responsible in realising the great role played by the stock market in the national economy. The second is the enactment of the Capital Market Law 2003 (CML’03) which is considered the first and only national securities law to govern all securities market activities and participants in Saudi Arabia. The CML’03 establishes an independent securities regulator, the Capital Market Authority (CMA), with the objective of protecting investor interests, ensuring orderly and equitable dealings in securities, and promoting and developing the capital markets. The third is that sincere efforts are made by the CMA to enhance the market and protect investors by issuing rules and regulations. However, there are thousands of potential investors who are looking for a more transparent and strong securities market.

While vibrant stock markets can bring growth for both the local economy and investors, the creation of such markets relies on strong regulation. It is asserted that strong regulation is crucial for the establishment of a strong securities market. The Saudi securities laws suffer from weak legal provisions and enforcement machinery. The cumulative effect of these shortcomings results in unstable securities markets.

This concluding chapter brings together the various strands of arguments and findings found in the previous chapters in respect of the abovementioned issues. In addition, it comes up with a number of specific suggestions and recommendations for improving the civil liability for defective disclosures in Saudi Arabia and consequently the investor protection.

1304 Ramady, above n 104, 158.
10. 2 Findings in the Introductory Chapters

Chapter 1 presents the general introduction of the study. Primarily, the lack of investor protection is considered as the major obstacle for the development of the securities market in Saudi Arabia. Weaknesses in legal provisions and enforcement machinery contribute to the weak protection of investors. The consequence of these shortcomings results in a fragile market. The chapter aims to justify the need for this study as an attempt to improve the market, and brings out its potential significance and expected contribution. It provides the research questions, and states the scope and limitations of the study. The research methodology adopted in this study gives details of the way in which the data is collected and treated.

It has been emphasised that the protection of investors in the Saudi stock market will be the hub of all discussions carried out in order to address the above three central questions. Providing such protection is crucial to restore and maintain investor confidence in the stock market.

Chapter 2 has discussed the key research question of the present thesis: ‘What is the importance of investor protection in the Saudi securities market?’ In addition, this chapter introduces the importance of Saudi Arabia as an independent country with the most traditionalist Islamic legal system in the world today. It shows that the Saudi Arabian economy is the largest amongst the Middle Eastern and Arab countries. Additionally, the importance of Saudi Arabia derives from its location as the heartland of Islam and the site of the two holy mosques and the focus of Islamic devotion and prayer. Moreover, this chapter identifies the main terms and concepts which have been the concern of the current study. It has been seen that investor protection is the
cornerstone of any securities regulation. In addition, optimal disclosure and transparency rules are of vital importance for the protection of investors in securities markets.

The significance of having a vibrant securities market to the economy of Saudi Arabia is discussed in Chapter 2. This chapter illustrates the history of the development of the securities market in Saudi Arabia since its inception in 1935 through to 2012. It also presents the infrequent attempts made by the authorities concerned to reform the market and increase market growth. The chapter shows the position of the Saudi securities market in comparison with its regional and international counterparts. After the major market collapse in 2006, the integrity of the market was subject to massive criticism from investors who called for governmental intervention and better control of market dynamics. This chapter identifies further drawbacks, which significantly delay the desired development and require legal intervention. These drawbacks are, namely: the small number of listed companies in comparison with scale of the economy; instability of the market caused by the unprecedented market collapse in 2006 and the correlation between the oil prices and the stock market; and the absence of foreign portfolio investment. As individual investors who lack experience in stock market do the majority of securities trading, it is highly recommended that they be encouraged to adopt trading through institutional investors as an effective solution as they will thereby be able to avail themselves of the expertise of experienced and knowledgeable personnel in those institutions, especially when such institutional investors work within a strong legislative framework with sufficient regulatory oversight together with adequate enforcement (as will be further outlined below). It is agreed that the growth of institutional investors and their use by individuals for their investments will be useful for the investor
Chapter 10: Findings and Conclusions

protection, the market and the economy as long as the institutions have a good ‘watchdog’ or supervisory regulations and enforcement.

Furthermore, this chapter demonstrates that weak transparency and poor disclosure practices by listed companies is a major impediment to the sustainable development of the securities market in Saudi Arabia. Most importantly, this chapter shows that the poor civil liabilities for defective disclosures have a considerable negative impact on market development. It has been seen that a strong civil liability regime will restore investor confidence and attract them to invest in the securities market. For that reason, this chapter concludes by exploring the meaning of civil liability which is a central term of the present study. However, it has been demonstrated that the need for information disclosure and transparency is crucial for market efficiency and, most importantly, for investor protection.

In Chapter 3, a survey of the legal regulatory framework of the securities market in Saudi Arabia finds that the promulgation of the CML’03 was fundamental to the market in Saudi Arabia. It presents an account of the development of the regulatory framework. The CML’03 replaced the vague legal and regulatory framework of the market before 2003. This chapter shows that the CML’03 is the law that governs securities market activities and participants in Saudi Arabia. The CML’03 is an ‘enabling law’ — it enables the CMA to be the regulator of the securities market and issue rules and regulations by law in order to oversee the market.

Whilst the introduction of CML’03 represented a great step forward, this chapter nevertheless detects some flaws in the current legal and regulatory framework of securities markets in Saudi Arabia. In reviewing the role of the regulator in relation to
Chapter 10: Findings and Conclusions

the market disclosure, the chapter demonstrates that the regulatory role of the CMA in regard to the disclosure regime is insufficient. It has been agreed that providing credible information will lead to greater market transparency and thereby a safer investment environment.

In addition to the above, discussions throughout the thesis prove that the current legal and regulatory framework for securities market in Saudi is ineffective in terms of the disclosure regime, civil liability and enforcement. Problems regarding civil liability and the regulatory weaknesses have been identified in the introductory chapters. In Saudi Arabia, investors who sustain loss or damage as a result of a violation of the disclosure regime remain uncompensated and wrongdoers go unpunished. The main findings of this thesis will demonstrate the need for reforms in the current legal provisions of disclosure regime and civil liability in order to facilitate the claim for compensation by aggrieved investors. Likewise, the weak regulatory enforcement mechanism makes the issue difficult.

10.3 Major Findings in the Thesis

In analysing the civil liability for defective disclosures in Saudi Arabia, the major findings can be divided into three main sections: disclosure requirements; civil liability provisions for the breaches of these requirements; and the enforcement machinery of the civil liability provisions. In the pursuit of the major findings, relevant provisions from the US, the UK, Australia and Canada have been discussed in line with their equivalent provisions in Saudi Arabia. Additionally, objectives and principles of the securities regulations stated by the International Organisation of Securities Commissions (IOSCO) have been used to measure investor protection in Saudi securities markets. The major
findings included in the following sections demonstrate that the current level of investor protection is weak in the Saudi securities market.

10.3.1 Major Findings in Relation to the Disclosure Requirements

The following findings answer the key research question: ‘Are the present requirements adequate to ensure full, fair and timely disclosure of material information by corporations in Saudi Arabia?’.

The requirement to disclose information is necessarily connected with liability for misstatements made in the course of that disclosure. Hence, it has earlier been submitted that an analysis of civil liability for defective disclosures begins with the requirement of disclosure. Saudi securities regulations have provided for prospectuses, continuous disclosures and periodic disclosures documents and granted the regulatory role to one body — in this instance the CMA — to govern, supervise and enhance disclosure requirements. A major development has been that the CMA has recently (2010) become a member of the IOSCO,\textsuperscript{1306} which requires more efficient and transparent disclosures in the secondary market. However, the CMA has been unsuccessful in strengthening investor protection in the IPO market in conformity with the IOSCO Objectives and Principles.

In reviewing the requirements for disclosure in the CML’03 and the CMA rules and regulations, the study finds that these requirements require improvement to ensure integrity and accuracy in the information disclosure. Generally, the study finds that unlike in the selected developed countries, in Saudi Arabia the matters of issuing new rules for, or improving or amending disclosure requirements have not been prioritised.

\textsuperscript{1306} ‘IOSCO Expands its Global Membership’, above p 22.
Chapter 10: Findings and Conclusions

In reality, no new rule, or improvement to or amendment of requirements in respect of the disclosure regime has been made since the CML’03 and the CMA rules and regulations came into existence.

In analysing the disclosure requirements for prospectuses and periodic disclosures and continuous disclosures, the study finds that the current Saudi laws and regulations do not include sufficient requirements for the concept of materiality.\textsuperscript{1307} Discussion shows that the requirement for materiality under the CML’03 is somewhat obscure. A clear standard to determine what should be considered material under the Saudi prospectus provisions is absent. This can be done by the adoption of a materiality test, which can be a significant element in examining misstatements even though the law does not generally require it.

In addition to the materiality test for information provided in all types of disclosures, the study finds that there is no verification test for prospectuses to be carried out by the CMA, while a mechanism to test the information in the prospectus has been adopted by most developed countries. Although the Saudi requirement under art 55 of the CML’05 for ‘all information’ equates with developed countries’ requirement, there is no further practical steps to test information materiality. The test is known, for example, in Australia as the ‘reasonable investor’ test. Therefore, the study suggests that the CMA to adopt a verification test in relation to prospectus contents. A requirement for verification of a prospectus, which involves checking each material statement of fact or opinion, is important to:

\begin{itemize}
  \item i. ensure that prospectus is accurate and complete;
\end{itemize}

\textsuperscript{1307} See section 4.4.2.
Chapter 10: Findings and Conclusions

ii. assist investors to make an informed investment decision;

iii. afford the persons involved in the prospectus preparation with a defence in relation to their potential liability for a defective prospectus; and

iv. strengthen disclosure in the Initial Public Offerings (IPOs) market.

Furthermore, the study finds that, under the current CML’03 and CMA rules, the issuing companies are not required to undertake a due diligence process during the preparation of prospectus.\(^{1308}\) A requirement should be introduced for the issuers to verify their prospectuses with a specialised committee before submitting the prospectus to the CMA. This is essential. This requirement has a twofold objective: to ensure that the prospectus complies with disclosure requirements; and to identify the due diligence committee as a liable person along with other persons who participated in the preparation of the defective prospectus. Therefore, in Saudi securities regulations, it is suggested that a robust due diligence process should maximise the likelihood that all material information is disclosed to the market and minimise the possibility of liability arising from defective disclosure. Moreover, the CMA has to perform a greater role to monitor disclosure in prospectuses and ensure that issuers are complying with the CML’03 and the rules and regulations set out by the CMA. Principle 16, regarding issuers, states that ‘there should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors’ decisions’.\(^{1309}\)

As in developed countries, the Saudi disclosure regime has recognised the continuous disclosure obligations.\(^{1310}\) In relation to the function and meaning of continuous disclosure, it has been found that the Saudi regulator has identified the need for

\(^{1308}\) See section 9.5.1.2.1.


\(^{1310}\) See section 5.3.1
Chapter 10: Findings and Conclusions

continuous disclosure and required listed companies to comply with such a requirement. However, it has also been found that art 7 of the Market Conduct Regulations 2004 (MCR’04) is insufficient in regard to who is responsible for continuous disclosure. It states the broad term of ‘person’ as being responsible for making disclosures without specifications or definition as natural and corporate person, which demonstrates a degree of ambiguity.

In respect of the periodic disclosure requirement under securities laws in Saudi Arabia, the preceding description of legislation and associated regulations in selected countries shows that Saudi Arabia has adopted the same approach in most regards, one that requires companies to disclose their financial reports quarterly and annually. However, the study finds that only annual reports are required to be audited whereas in other developed jurisdictions every periodic report has to be audited to ensure the adequacy of the information released to the public.

Thus, the Saudi securities regulator needs to insert a legal requirement that stipulates that listed companies should audit their quarterly financial report before it is disclosed to the public. It is believed that the auditing of quarterly reports will lead to:

i. accurate advice given by financial analysts, who rely on information contained in the quarterly reports;

ii. reduced risk in regard to investment decisions and investments in the market that are made in accordance with those quarterly financial reports; and

iii. increased reliability of reporting which contributes to the overall degree of investor confidence.

1311 See section 5.4.3.
Chapter 10: Findings and Conclusions

All of the above will strengthen the fairness of the market and thus increase the protection of investors. However, the study finds that although the CMA is a member of IOSCO, it does not completely satisfy that organisation’s principles in respect of periodic disclosure.

10.3.2 Major Findings Concerning the Civil Liability Provisions for Breaches of the Disclosure Requirements

Civil liability provisions have been discussed throughout Chapters 4, 5, 6 and 7. In this regard, the following key research questions were discussed: ‘What is the scope of contravention of these requirements which would attract civil liability?'; ‘Who can be held liable for a disclosure containing untrue and misleading information under Saudi law?'; ‘What are the strengths and weaknesses of the civil liability regime for corporate disclosures in Saudi Arabia in order to protect investors?'.

In analysing the civil liability provisions for defective disclosures under the Saudi securities laws, the study finds that these provisions are inadequate in terms of the articulation of liabilities, remedies, defences and evidence. The study ascertains that the civil liability provisions for defective disclosure in Saudi Arabia are weaker than their equivalents in the US, the UK, Australia and Canada.

In regard to prospectus liability, the study shows that both Saudi Arabia and developed countries impose civil liability for a defective prospectus. It shows that the issuers, directors, underwriters and experts are liable in these jurisdictions for defective prospectuses. Unlike Saudi law, the laws of these selected developed jurisdictions clearly impose civil liability on parties other than those stated in art 55 of the CML’03. Nevertheless, it is found there are other persons who are involved in the preparation of

1312 See section 4.6.
Chapter 10: Findings and Conclusions

the prospectus and do not fall within the ambit of this liability. Those persons are, namely: promoters, lawyers and issue managers. The discussion on the roles of promoters, issue managers and lawyers demonstrates the important role played by promoters and issue managers in providing separate certification to the fact that they have examined a prospectus. In addition, the discussion proves that lawyers play a significant role in corporate fundraising. Discussion of the roles of promoters, issue managers and lawyers and the rationale for their liability for a defective prospectus demonstrate the need to improve the civil liability provisions to include all persons participating in the preparation of a prospectus.

Furthermore, unlike the law in the selected developed jurisdictions, it can be found that the Saudi law includes the vague expression, ‘any person who has been mentioned in the prospectus and has certified any part of the prospectus will be exclusively liable for the part he/she certified’. This urges a clear specification for who can be held liable for the untrue statement or omission from in the prospectus documents. The lack of clarity regarding civil liability of those persons who are not specifically mentioned in the prospectus civil liability provisions would generate uncertainty in relation to the law concerned.

Chapter 6 has discussed the two key research questions of the present thesis. These questions are ‘What remedies are available for breaches of civil liability provisions for defective disclosures?’ and ‘Are the present remedies adequate to compensate victims and to create deterrence against contraventions?’. The study shows that investors in the Saudi securities market have two causes of action under the CML’03. The first cause of action is that of the existence of defects in prospectuses. The second is that the cause of

\[1313\] Capital Market Law 2003 (Saudi Arabia) art 55.
action is based on defects in any disclosure documents in connection with sale or purchase of a security. The analysis of the available remedies reveals that investor remedies for breaches of the disclosure regime are inadequate under the current civil liability provisions for defective disclosures.

Although the remedy of damages could be available to compensate the plaintiff’s loss resulting from the breach of the disclosure requirements, it remains the only relief available to investors. In addition, this chapter demonstrates several drawbacks associated with the remedy of damages. The discussion shows that the remedy of damages is unclear. In contrast, aggrieved investors in the developed markets have statutory remedies other than damages available to recover their losses, such as: rescission, the right to withdraw and have money returned, and the right to return the securities and be reimbursed the amount paid for those securities.\textsuperscript{1314}

Furthermore, this chapter demonstrates that the securities class action is an effective remedy for aggrieved investors as well as a deterrent to potential violators. Nevertheless, the possibility of a securities class action does not exist in Saudi Arabia. Moreover, it has been observed that the current limitation period of one year is inadequate and contrary to investor protection. The twelve-month period during which the aggrieved investor can bring a legal action seeking compensation for the violation of the disclosure regime starts from when the investor first realises that he/she has been a victim. Thus, a recommendation is made to increase the limitation period to more than one year as it is in some developed jurisdictions.\textsuperscript{1315}

\textsuperscript{1314} See section 6.4. \textsuperscript{1315} See section 6.6.3.
Chapter 10: Findings and Conclusions

The study confirms that the weak investor remedies for defective disclosures will undermine investor protection by:

i. allowing investors remain uncompensated,

ii. permitting wrongdoers go unpunished, and

iii. providing incentives for market participants not to comply with the disclosure regime.

The key research question ‘What defences are available to escape liability, and how and when can these defences be relied upon?’ has been answered in Chapter 7 which deals with defences available for defendants to avoid civil liability for defective disclosure.

Hence, in investigating the provisions of defences to civil liability for defective disclosures under the Saudi securities laws, Chapter 7 demonstrates that these defences remain ambiguous and unclear. This chapter finds that the due diligence, lack of causation, purchaser’s actual knowledge of the alleged breach and lack of authorisation are the defences which are available for defendants in contravention of prospectus requirements in Saudi Arabia. Moreover, defendants can avoid civil liability for defective disclosures in the secondary market by proving a lack of causation or lack of authorisation.

However, the articulation of the due diligence defence is inadequate under the current Saudi civil liability regime for defective disclosures. There is a significant lack of interpretation regarding the ‘reasonableness’ standard, that is, of what constitutes reasonable investigation and reasonable grounds. This is coupled with missing criteria, namely what constitutes a reasonable investigation and reasonable grounds in respect of

1316 See section 7.4.
the defence of due diligence. A clear standard regarding reasonableness in the due diligence defence is needed. The law is required to clarify the difference between the executive directors and non-executive directors in respect of the due diligence defence. This is because, equally with the executive directors, the non-executive directors should carry the burden of knowing the truth of the information provided in the prospectus.

As regards the evidence in securities litigation, it has been argued that although the current laws dealing with the evidence under the CML’03 have procedural rules, they lack the substantive rules that are significant for the law of evidence and the concept of fair trial. Besides, the absence of a comprehensive written code of evidence under the Saudi legal system makes the issue more difficult.

10.3.3 Major Findings Regarding the Enforcement of the Civil Liability Provisions

This section summarises the major findings which are related to the two key research questions: ‘What are the strengths and weaknesses of the judicial enforcement of the disclosure requirements currently in place in Saudi Arabia?’ and ‘What are the strengths and weaknesses of the administrative enforcement of these requirements and how effective is the role of the market regulator in protecting securities investors in Saudi Arabia?’.

Without an efficient enforcement mechanism alongside the liability regime, any law will be worthless. Effective enforcement is essential to help establish the rule of law. The enforcement mechanism of the securities laws in Saudi Arabia has been carefully investigated. Chapter 8 recognises flaws that persist in the judicial enforcement

1317 See section 7.4.2.
Chapter 10: Findings and Conclusions

mechanism. Central to the main findings is that the inadequacy of the current securities courts is causing difficulties for the issue of securities laws enforcement in Saudi Arabia. It has been demonstrated that the having just one bench of three members to deal with all securities allegations arising from the market is not an effective approach to dispensing justice in an efficient manner. This situation has led to slow processing which in turn leads to victims being reluctant to lodge a claim. In addition, they may not be able to claim for their loss or damages. Hence, the number of judges must be consistent with the number of cases, especially, given the fact that the CML’03 does not place any restrictions on the number of members of the Committee for the Resolution of the Securities Disputes (CRSD) as well as for members of the CRSD.\textsuperscript{1318} In order to deal with the large number of cases pending in the CRSD, it is imperative that the number of courts and their members be increased so as to restore public confidence in the judicial enforcement of securities laws.

Moreover, this study finds that the judicial independence of the securities courts is weak. Members of the securities courts are not independent in their administration of justice. They are engaging in other paid employment and activities in both the government and private sector. In addition, there is no statutory protection for the members of these courts. Under the Saudi securities laws, there is no mention of judicial accountability for the members of the securities courts in Saudi Arabia (namely the CRSD and the ACRSC).\textsuperscript{1319} Judicial accountability has a considerable impact on the balance between judicial independence and impartial justice.

\textsuperscript{1318} See section 8.4.1.
\textsuperscript{1319} It is worth reiterating that both of these bodies while functioning as courts are ‘committees’, hence the call for a form of judicial accountability and oversight.
Chapter 10: Findings and Conclusions

According to the provisions of the CML’03, a member of the securities court in Saudi Arabia is empowered to fine and impose a term of imprisonment of up to five years. It is suggested that the Law of Judiciary 2007 (Saudi Arabia) (LJ’07) to be applied to the members of the CRSD and the Appeal Committee for the Resolution of Securities Conflicts (ACRSC). This is because the LJ’07 provides judges with independence, protection and accountability.

It has been shown that the bench dealing with securities cases in Saudi Arabia lacks sufficient training and experience in relevant law and practice. The main causes for such inadequacy in terms of experienced and well-trained judges are: lack of legal education; lack of prior legal practice; and lack of practical experience in dealing with cases involving disclosure allegations. For example, holding a formal legal qualification is not compulsory for a person willing to be appointed as a member of the higher securities court (the ACRSC) which has the power to impose imprisonment for up to five years. Hence, a suggestion that legal background as well as practical experience should be required on any person appointed as a member of the ACRSC.

Furthermore, it has been found that the lack of skilled lawyers dealing with securities litigation hampers the judicial enforcement of securities law in Saudi Arabia. The main reasons for such a scarcity are the non-availability of courses on securities law in the law schools and the serious lack of securities case law. Generally, the number of lawyers is insufficient when compared with fast growing population of Saudi Arabia as well as the rapid growth of the securities market. There are only 1611 lawyers registered, which is relatively low compared to the country’s population of over 27 million (as of 2011). The lack of lawyers, together with the absence of an independent
bar council, may have a negative impact on the legal profession in Saudi Arabia.\textsuperscript{1320} Hence, it is suggested that providing courses on securities laws in the universities will make a positive contribution to the legal interface\textsuperscript{1321} with securities cases in the long term.

It has been provided that the CMA is entitled to bring suits before the CRSD on behalf of the investor. In this regard, according to art 59 of the CML’03, the court has to determine a range of remedies. The discussion finds that although the courts remedial powers are presented in a direct format, they are broad and have little specificity. The CMA appears to have little function in practice in gaining compensation for victims. Hence, the judicial enforcement is impeded by the weak role of the CMA in exercising its role to protect the public and bring actions against the violators of the disclosure regime.

Weaknesses in the judicial enforcement result in ineffective performance of the securities courts. It has been shown that there is a low number of resolved cases compared with the number of cases lodged. It is suggested that rules, criteria and methodology for ascertaining the quality and performance of judges could play a significant role in improving the judiciary in whole. Besides, the absence of an organisation to monitor the judiciary weakens the enforcement of laws in Saudi Arabia. A recent empirical study suggests several benefits of having specialised organisations to evaluate the judicial performance and quality, based on courts’ productivity.\textsuperscript{1322} Some of the most important of these benefits are the enhancement of the judicial performance

\textsuperscript{1320} See section 8.4.4.
\textsuperscript{1321} Lawyers and judges the members of the CRSD and ACRSC. It should also positively impact on the strength of the corporate sector to comply due to the improved legal training of those working in that sector who are responsible for disclosure, production of materials and so on.
\textsuperscript{1322} Choi, Gulati and Posner, above n 990.
and the support of legal research.\textsuperscript{1323} The need for a single body, which can put in place guidelines and standards to oversee productivity and conduct, is imperative for enhancing the quality of the judiciary. In this respect, it is believed that such guidelines will provide an excellent list of standards to determine whether a judge meets the requirements of his or her office and demonstrates appropriate accountability.\textsuperscript{1324} This is of course in addition to having sufficient, independent, well-trained judges and lawyers as emphasised earlier.

Chapter 9 discusses issues relating to the effectiveness of the administrative enforcement of the securities laws in Saudi Arabia and the role played by the CMA. Despite the recent trend to increase the powers of the regulator, this study attempts to balance the regulator’s powers. Accordingly, it is essential that the regulator can implement the laws and act on behalf of the public interest. The reality is that the CMA has been desperate to restore investor confidence in the securities market. This study finds that the role of the CMA in enforcing the disclosure regime is ineffective. Flaws centred on a lack of transparency in the securities market. The CMA needs an efficient system to discover and detect violations of the disclosure regime. It has been found that the absence of precise monitoring of all corporate disclosures is a significant cause for disclosure violations. As many violations occur without being discovered by the CMA, investors remain without protection. What makes the issue difficult is that there have been no studies carried out by the CMA to assess transparency in the market, and public satisfaction and confidence in the market.

\textsuperscript{1323} Having evaluating or ranking organisations would enhance judicial performance by making available the best judicial opinions produced by a court, increase public awareness of the performance of courts in their area and the knowledge of how judges are selected and of their performance. In respect of legal research, lawyers and scholars who are researching for leading cases would benefit from knowing which courts are most likely to produce these cases. For details, see ibid.

\textsuperscript{1324} Penny J White, above n 921, 1068.
Chapter 10: Findings and Conclusions

It has been shown that the current administrative fines are negligible and not creating deterrence for potential violators. Evidence is provided by some jurisdictions that the availability and imposition of significantly high-value administrative fines creates deterrence and consequently compliance with the disclosure requirements. Moreover, this study demonstrates that weak intervention by the CMA to control the market shows its lack of regulatory experience in enforcing the law.\textsuperscript{1325} Although the CMA has enforcement tools given by the CML’03 and enforcement machinery through its departments to oversee violations and carry out enforcement, the detection and investigation departments in the CMA may require reform. Unlike the CMA, general investors do not have the ability or the technology to detect disclosure violations in the market. In contrast with developed jurisdictions, the CMA also lacks the power to impose a stop order. It is suggested that the CMA be armed with the power to issue a stop order on a prospectus when it detects matters that give rise to concern that investors and their professional advisers would not be able to make an informed investment decision.

It has been found that some investors have left the market because of the regulator’s failure to use the powers available or for the overuse of these powers. Hence, this study calls to strike a balance between the two extreme approaches.\textsuperscript{1326}

This chapter has revealed an insufficiency in the regulatory role regarding information intermediation. This has been done by showing the weak role played by the CMA in regard to auditors, financial analysts and rating agencies and their role in the disclosure regime.

\textsuperscript{1326} See section 9.3.4.
Chapter 10: Findings and Conclusions

The discussion on auditors concludes that having well-trained auditors and high standards for accounting professionals will result in better disclosures by corporations in the Saudi stock markets. A recommendation is made that the CMA issue rules for the auditing standards performed by auditing firms registered with the Saudi Organisation for Certified Public Accountants (SOCPA).

It has been found that there is a serious lack of sophisticated financial analysts in the Saudi stock market. In addition, the role of the CMA in regard to financial analysts as market intermediaries is completely absent. A suggestion has been made to issue regulation governing the qualifications and activities of the financial analysts in the stock market.

Moreover, this chapter finds that the Saudi Stock Exchange (SSE) is not exercising its role as a ‘Self-Regulatory Organisation’ (SRO). The enabling nature of the CML’03 only allows the SSE to propose rules and standards for the operation of the market. These proposals require approval from the CMA to be effective. Examples from different selected developed jurisdictions show that their market exchange operators can issue rules, instructions and directives to ensure that a transparent trading system is in place. This chapter shows that the transparency in Saudi securities market is suffering from not having reliable credit rating agencies (CRAs) in the country as well as the absence of laws to govern their activities. The relation between having regulations to regulate the CRAs and the protection of investors has been shown to be significant. This chapter concludes by revealing the need for reforms in the regulatory function of the CMA in regard to the disclosure regime.
Chapter 10: Findings and Conclusions

Evidence is provided that the weak performance of the CMA in releasing news and information regarding the market was one of the main reasons for the inadequacy of the market. Therefore, the CMA announcements should be professionally executed in a timely and considered manner, especially, during the market boom and fall. In addition, news to be released by the market regulator needs to be carefully assessed prior to its release.

Furthermore, a regulatory reform needs to consider the role of the SSE, as an SRO, which should be expanded to institute proceedings for violations of the continuous disclosure rules. Evidence is presented that the stock exchange in some developed jurisdictions has the right to carry out actions against the breaches of the disclosure requirements during the listing period of the company. This is believed to be effective in regard to creating deterrence and hence better compliance with the disclosure requirements.

The effectiveness of regulation relies on the qualifications of the persons entrusted with regulatory responsibilities. It is submitted that the CMA is to be comprised of members with sufficient experience in the private sector and corporate management, adequate legal education and practice. Members of the CMA are required to have expertise in the field of the private sector and especially the securities markets. This will help the regulator in addressing the market problems and restoring public confidence. Moreover, considering the complex nature of the securities laws, legal knowledge is crucial for a capable securities regulator. Under the Saudi securities laws, there is no statutory requirement for a special knowledge of law as a requisite qualification for a member of the CMA. Therefore, it can be recommended that Saudi securities laws be amended to include legal education/experience as a requisite qualification for at least the chairman.
of the CMA as well as for at least one other member. It is submitted that persons with
law degrees need to be taken into consideration in the appointment of the members of
the CMA. In addition, having representatives of the market participants in the
composition of the CMA is important because they have experience in the corporate
management. Unfortunately, there is currently no provision for the appointment of
market participants in the regulatory body.

As the current CMA consists of five members including the chairman, a suggestion is
made to have a member from the following categories. These are: legal scholars
specialising in securities law, private sector professionals, market participants and
finally, a member who has had practical experience as solicitor in commercial litigation
and capital markets issues. Evidence is provided that the majority of members of the
securities regulators in developed countries are chosen from those who have practised
law. In all cases, the chairperson must be always chosen from those who have higher
law degrees.

However, having an accountability mechanism for regulatory misconduct or malpractice
is imperative for the maintenance of public confidence in the market. For that reason, it
is important to hold the persons entrusted with market regulation accountable, and be
able to discipline them if the need arises. It is suggested that a degree of judicial
oversight be implemented to permit the investigation of any allegations raised against
CMA members in relation to the performance of their duties.

The review of the administrative enforcement decisions is available in Saudi Arabia.
Nevertheless, it is unclear whether a person can submit a claim directly to the CRSD or
whether it has to initially be placed in the hand of the CMA. In both situations,
However, a review of the particular decision is done by the CRSD. The main concern here is that the CRSD was established by the CMA which also appoints the members of the CRSD. This close association has led to accusations that the latter is under the power and influence of the CMA, and therefore the affected person may be disadvantaged by a lack of alternative judicial scrutiny. Likewise, an allegation against a member of the CMA should be heard before a general court of law rather than the securities court which can be seen to be under the influence of the members of CMA.

To provide stronger investor protection, market malpractice can be controlled by two different methods; these can be termed as ‘indirect protection’ (pre-violation) and ‘direct protection’ (post-violation).

Indirect protection aims to prevent the violation from occurring and can be implemented in two ways: firstly, investor education; and secondly, regulatory intervention prior to the release of the disclosure document. In regard to investor education, ongoing investor education programs are highly recommended. Evidence is provided from different jurisdictions that shows that securities regulators there have a statutory obligation for educating investors. A recommendation is also made that emphasises the importance of having a separate government institution responsible for educating and training market investors. The positive outcomes of this kind of education will not only be a better understanding of investment, but also greater investor sophistication.\textsuperscript{1327} Proper investor education will reduce the investment risk and therefore provide stronger protection for investors.

\textsuperscript{1327} Law, above n 1215, 39.
Chapter 10: Findings and Conclusions

For the purpose of the regulator’s intervention prior to the release of the disclosure document, the CMA must pursue a strong system of verifying disclosure documents before they are released to the public. The CMA must have a specialised department to accurately verify the drafts of prospectuses, continuous and periodic disclosures documents before they become available to the public. The objective of such department is to prevent the violation of the disclosure regime in particular and securities laws in general. Hence, until the investors have sufficient knowledge and the services of financial advisors are readily available in Saudi Arabia, the necessity of an effective verifying body is evident.1328

Direct protection aims to remedy the violation and enable injured investors to seek compensation. In this regard, the CMA must conduct the investigation process having adequate powers to do so effectively and using such powers that are provided effectively. The study finds some flaws in regard to the investigative powers of the CMA. There are no clear regulatory structures for the period prior to the investigation. Although the CML’03 empowers the CMA to undertake an investigation, it does not give details of the procedure for carrying out this investigation. The general provision of investigation powers to the CMA is lacking in detail concerning the criminal procedures for manipulative conduct. The CML.’03 does not provide the legal proceedings in criminal matters.1329

Effective investigative powers require additional resources and well-developed mechanisms that must be provided for the CMA to effectively track new violations throughout the market as they occur. To effectively identify market malpractice, it is

1328 See section 9.6.1.
1329 The availability of criminal prosecution as a deterrence is beyond the scope of this thesis.
recommended that the investigation department of the CMA be composed of people with high technological expertise, extensive market experience, and keen mathematical minds trained in finance.

The CMA needs to observe the IOSCO Objectives and Principles in order to improve investor protection in Saudi Arabia so that it is on par with its equivalents in developed countries.

**10. 4 Final Thoughts and Way Forward**

Investor protection is the cornerstone of securities regulation. Similarly, the development of the securities market requires efficient regulation. This study demonstrates that the current civil liability regime for corporate disclosures in Saudi Arabia is inadequate from the perspective of investor protection. It is believed that this drawback in the legal provisions produces weaker protection of investors in the disclosure regime in Saudi Arabia. However, the following provides the answer for the key research question, namely: ‘How can the Saudi corporate disclosure regime be further improved to protect investors?’.

In order to improve the investor protection in the securities market, Saudi securities laws should follow the path of the selected developed countries. This is because selected developed countries have a long history of dealing with securities cases and of judicial interpretation of securities law. Moreover, the CMA is required in practice to apply the IOSCO Objectives and Principles for Securities Regulation.

The CMA should strictly maintain investor protection and therefore adhere to the Objectives and Principles of Securities Regulation set out by the IOSCO. The objectives for the regulator in this IOSCO policy framework include: protecting investors;
ensuring that markets are fair, efficient and transparent; and reducing systemic risk.\textsuperscript{1330}

In addition, the CMA is required to adopt clear and consistent regulatory processes as stated in Principle 4 in the IOSCO Objective and Principles. Principle 7 requires the regulator to contribute to a process to review the ‘perimeter of regulation’ regularly.

Certainly, improvements to the current disclosure regime are needed to provide an efficient and transparent market comparable to that of the selected developed markets. As an empirical study of 2009 reveals that ‘corporate governance in Saudi Arabia is characterised by a lack of accountability, a weak legal framework and poor protection of shareholders’.\textsuperscript{1331}

Securities regulations need to be responsive to financial crises. Securities regulatory bodies have a duty to correct and review their laws in order to have a better market with strong investor protection. A recent study shows that it is essential for the protection of investors that an effective action be taken by securities regulators after a financial crisis.\textsuperscript{1332} Securities regulators need to consider useful disclosure requirements as part of their response. For example, after the meltdown of Enron in late 2001, the US enacted the \textit{Sarbanes-Oxley Act} 2002, which aims to increase the protection of investors in the securities market.\textsuperscript{1333} The need for effective regulation for the secondary market is essential for the protection of investors in the SSE, especially after the market collapse

\begin{footnotesize}
\textsuperscript{1330} IOSCO, ‘Objectives and Principles of Securities Regulation-2010’, above n 18.
\textsuperscript{1331} Falgi, above n 36.
\textsuperscript{1332} Mark K Brewer, Orla Gough and Neeta S Shah, ‘Reconsidering Disclosure and Liability in the Transatlantic Capital Markets’ (2011) 9 \textit{DePaul Business and Commercial Law Journal} 257, 291. See also the \textit{Financial Services and Markets Act 2000 (Liability of Issuers) Regulations 2010} (UK), which established a statutory civil liability regime for misleading statements in periodic disclosures to the market by issuers of securities. In Canada, securities regulators implemented a new rule for continuous disclosure requirements, which is to be found in National Instrument 51–102 \textit{Continuous Disclosure Obligations}. In Australia, amendments have been carried out by the securities regulator to provide more efficient protection for investors. For instance, the \textit{Corporations Act 2001} (Cth) extends the ambit of civil liability for continuous disclosure violations to be imposed on individuals, not just the company.
\textsuperscript{1333} Brewer, Gough and Shah, above n 1332, 263.
\end{footnotesize}
in 2006. Consequently, the role of the CMA as the supervisory and regulatory body of the securities market needs to continue to develop and embrace further refinement of its rules and regulations, especially regarding secondary market disclosure.\footnote{For example, Fanto illustrates the SEC’s traditional mission as disclosure-related to securities transactions; see James A Fanto, ‘We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education’ (1998) 49 Case Western Reserve Law Review 105, 156.}

It has been seen that the Saudi civil liability provisions for defective disclosure are, principally, a direct translation of the equivalent provisions of the US \textit{Securities Act 1933}.\footnote{Baamir, ‘Issues of Transparency and Disclosure in the Saudi Stock Market’, above n 23.} It is clear that the US provisions have witnessed a historical development since they came into existence. In order for this importation to suit Saudi securities market conditions, a greater role is required by the government, the CMA and for court interpretations of these provisions. Thus, it is strongly suggested that the regulator of the Saudi securities market utilise and benefit from the US developments.

Arguably, there is a need to take into account further causes that have contributed to the lack of investor recourse to the courts for remedial action. These reasons are: the absence of the legal knowledge amongst investors, the likely small amount of loss so investors do not care to pursue the matter, in the face of the cost of litigation, and the delay in delivering the judgments. Questions remain, therefore, as to how general investors initially can know that their loss was not normal and resulted from a breach of the law,\footnote{Althanyan, ‘The Announcement of the CMA Regarding the Right of Victims to Sue Is Inadequate’, above n 1028.} and how such general investors can prove their right to compensation.

A significant point is that the combination of the serious lack of case law and absence of interpretation by courts has considerably contributed to the ambiguity of civil liability regarding the defective prospectus.
Chapter 10: Findings and Conclusions

So far, there have been no studies carried out by the CMA to assess transparency in the market, and public satisfaction and confidence in the market. Thus, the issue of market regulation becomes difficult, especially with the serious dearth of extensive legal research on the aspects of the administrative enforcement of securities laws in Saudi Arabia.

Equally important, the need for ongoing research and studies is significant in relation to the regulator’s role in protecting investors. Tomasic suggests that academic researchers have an important role to support regulators in order to implement effective enforcement strategies. Therefore, there is a need for cooperation between the CMA and scholars in the field of securities laws in order to enhance the effectiveness of the securities laws.

Indeed, the law interferes in the securities market to provide protection for investors from unfair practices. Sufficient and adequate investor remedies against breaches of the disclosure regime together with effective enforcement machinery will create strong incentives for market participants to comply with disclosure requirements and therefore lead to improved investor protection.

Consequently, the author believes that strengthening the civil liability for the breaches of disclosure regime can promote better protection for investors in both IPOs market and the secondary market in Saudi Arabia. This protection will help restore investor confidence in the market and therefore attract greater investment.

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Chapter 10: Findings and Conclusions

On the basis that the interests of investors impose on market participants a duty of disclosure and thus transparency, this thesis attempts to determine what will serve to foster a fair, efficient and competitive capital market environment. If such a worthy objective is to be achieved, it is important that the law relating to continuous as well as periodic disclosure is robustly enforced.

Throughout this thesis, it has been seen that the focus is civil liability for defective disclosures as an effective means of providing protection for investors in the securities market in Saudi Arabia. However, when it comes to the absence of a viable disclosure regime, surely it is not due just to the lack of transparency, but also the lack of certain prerequisites. These prerequisites have to do with investors’ ability to make prudent investment decisions in the use of disclosure in the prospectus, strong legal regulatory and enforcement framework for investor protection, dominance of institutional investors and, finally, the availability of an investment advisory service (and education) and retail research to throw more light on the nature of the disclosure of issuers. Laws dealing with these issues may be a suitable field for profound examination in order to provide comprehensive protection for investors in the Saudi stock market. Such examination may be the subject of further research.
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