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# Brokers' Liability For Capital Market Manipulation: A Comparative Study Between The Saudi Law And Egyptian Law

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## Abstract:

Brokerage companies' manipulation of securities prices causes significant losses for investors, thus forms of manipulation done by those companies were studied, and liability was proven under Saudi and Egyptian laws. The study resulted in limiting capital market brokerage to joint stock companies. There is a link between broker manipulation of securities prices, failure to respond to investor complaints, the exit of many small investors from investing in securities, and considerable disparity in sanctions between Saudi and Egyptian laws.

**Keywords:** Liability, Brokerage, Securities, Manipulation, Saudi Capital Market Law, Egyptian Market.

## 1. Introduction:

The capital market is one of the solutions used by investors of various financial cultures to maximize profits but without a thorough understanding of market transactions, which may expose them to serious harm due to dangerous speculation that threatens their financial wealth. Protecting customers from some brokerage companies' manipulation is a critical issue caused by these companies, who manipulate the pricing of securities inside and outside the market. From this point, state legislators have organized the activity of brokerage companies as an intermediary between fund owners and companies that issue securities to safeguard investors speculating in securities while also developing the national economy through the capital market.

The Kingdom of Saudi Arabia has paid great attention to this matter. It issued Royal Decree No. (M/30) dated 2/6/1424 AH and Cabinet Resolution No. 91 dated 16/4/1434 AH to regulate the issue and trading of securities, monitor the activities of companies regulated by the Authority, establish tight standards to promote integrity and transparency in capital market transactions, and apply harsh penalties for manipulating security prices.

In this study, we will review and study the forms of manipulation in the capital market, and determine the responsibility of brokers resulting from brokerage companies' manipulation in the Saudi capital market compared to the Egyptian capital market.

### • The Problem of the Research:

The problem of research lies in the regulatory shortcomings in dealing with forms of manipulation in the capital market, and based on this shortcoming, many questions arise, including: How does Saudi Arabia's capital market law resist securities price manipulation? What is the legal nature of brokerage companies' liability in the Saudi capital market?

### • Research Objectives:

The research aims to:

- Highlight the forms of brokers' manipulation of the securities prices.
- Clarify the legal liability for manipulation in the Saudi capital market law compared to the Egyptian capital market law.
- Provide legal and practical solutions to the problems that result from manipulating the securities prices.

### • The Importance of the Study:

The researcher believes that this research is crucial for understanding the role of brokerage companies in the capital market and the related economic and social impact on the segments of society.

### • Scope of Study:

This study objectively determines the civil liability of financial brokers in the Saudi capital market by highlighting the Capital Market Authority Law issued by Royal Decree No. (M/30) dated 2/6/1424 in comparison to the Egyptian Capital Market Law issued by Law No. 95 of 1992 and its Executive Regulations.

## 2. Previous Studies:

By reviewing the intellectual production published in Arabic and English languages in the various databases, and related to securities brokers' manipulation, it was found that there are (50) researches, and when the researcher reviewed those searches, she found that the researchers that are closely related to the research topic are (6) researches, including the following studies:

The application of civil liability faces legal obstacles due to the difficulty of proving the causal relationship between the violation of disclosure requirements and the loss of investors, and that it is not possible to determine the amount of damage caused to the investor as a result of the breach of disclosure (Shamsollahi, 2021). There is a close link between the integrity of the internal market and the credibility of brokers (Ellen& others, 2017). The Kuwaiti law of 2010 partially succeeded in protecting investors by prohibiting insider dealing, but it did not properly define insider dealing, and it is a complex crime that is not easy to combat because of the difficulty of proving (Al-Shebli, 2019). The confidential nature of internal information appears on two sides, the first is that it shall not be disclosed except to certain people, and the second is its importance because it affects the price of the securities, and that the Saudi regulator did not stipulate imprisonment as a penalty for the majority of crimes (Al-Yabis, 2018). Maintaining the customer's secrets, as well as the obligation to disclose and be transparent regarding the client's information, are not the source of the brokerage contract, but rather a legal requirement imposed on the broker. The broker's responsibility covers its employees' acts, as well as compensation for any material or moral damage incurred by the customer. The broker is exempted from contractual and tortious civil liability if it is proven that the error was due to a foreign cause beyond its control, or that the injured person himself is the one who caused the damage or participated in its occurrence (Ramadan, 2016). The investor bears the burden of proof against the broker, who is liable for his job, by establishing error and damage, as well as the causal relationship between the error and damage (Al-Tuwaijri 2014), the existence of unusual trading patterns and profit differences arising from deals between brokers and outside investors in emerging markets, and that manipulation of stock prices is done by complicit brokers (Nguyen, Tran, Zeckhauser, 2017). The negotiable instrument broker obtains a license and is subject to obligations that are commensurate with the nature of his profession and what permits him to access the secrets of customers and investors. The broker shall refrain from disclosing such secrets under agreement or law. The broker is committed to transparency (Jaradt, 2022). Stock price manipulation occurs frequently in companies that have governance problems (Yuhsin & others, 2022).

### 3. Research Methodology:

The descriptive, inductive, and comparative analytical approach to analyze the provisions of the Saudi Capital Market Law and whether it is ineffective in protecting customers or not, so that the regulator plays its role in making the necessary amendments to achieve more equal protection of customers, balancing the interests of customers, and the objectives of establishing these companies to achieve economic development in the Kingdom of Saudi Arabia, compared to the applicable provisions of Egyptian law.

#### 3.1. Research Plan:

Legal logic requires that before addressing the forms of brokers' manipulation of the securities prices, and the nature of the legal responsibility resulting therefrom, we shall learn about brokerage in the capital market and its importance in a preface, and then we address the forms of securities brokers' manipulation of in the first topic, and the responsibility of the brokerage company towards the customers in the second topic.

##### 3.1.1 Preface:

###### • Brokerage Concept:

The brokerage contract is considered one of the important commercial contracts that many commercial legislations have paid attention to and regulated, and the concept of brokerage entails brokering in concluding contracts. Article (30) of the Saudi Commercial Court Law defines the broker as "one who mediates between the seller and the buyer to complete the sale for a fee". Article (192) of the Egyptian Trade Law No. 17 of 1999 defined the brokerage contract as "a is a contract under which the broker undertakes to a person to look for a second party to conclude a specific contract and mediate for its conclusion". The previous definitions of the broker make it clear that it is simply a broker whose role is limited to the material side<sup>1</sup>, which is to find a person who agrees to contract with his customer for a fee<sup>2</sup>, does not take legal action<sup>3</sup>, and bears no risks in the transactions that this broker mediates in general. As for the brokerage of negotiable instruments, which is the subject of our research, it is required to be a company approved by the competent authorities to deal in the stock exchange.

###### • Definition of Securities Brokerage Company:

**A Capital Market Broker** is a legal person represented in a brokerage company. Only brokerage companies licensed under Saudi and Egyptian legislation may conduct some or all of the investor's securities transactions. The Saudi Capital Market Law and the Egyptian Capital Law both mandate that the broker operate as a shareholder company.

Article 32 of the Capital Market Law issued by Royal Decree No. (M/30) issued on 2/6/1424 AH defined the broker as "a joint stock company that carries on brokerage activities and the broker agent who is working at the brokerage company", and Article (31) of the Law stipulated that no person may carry out any of the activities of brokerage or claim to practice it unless it has obtained a license from the Authority or working as an agent for a joint stock company licensed to conduct brokerage works unless that person has been excluded from those requirements according to paragraph (c) of Article (32)."

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<sup>1</sup> Georges Ripert, *Traite elementaire de Droit libraire*, edition par Rene Roblot, Paris Libraire, Generale de Droit et de Jurisprudence (1979) P. 243.

<sup>2</sup> El Aybuke, Adel Ramadan, *Securities Brokers in the Legislation of Arab Countries*, Al-Ahram Economic Book, Cairo, Egypt, No. 86, 1995.

<sup>3</sup> Sadiq, Morris, *Commercial Encyclopedia*, Dar Al-Kitab Al-Dhahabi, Egypt, 1999, p. 358.

The text of Articles (31) and (32) referred to above clearly shows that the law limited brokerage in the capital market to the legal person that takes the form of a joint stock company only, and that the broker must obtain a valid license to practice the brokerage profession,<sup>4</sup> but it did not clarify the legal nature of the legal status of the negotiable instrument broker, particularly its relationship with its customers.

As for Egyptian law, Article 26/6 bis of the Egyptian Capital Market Law No. 95 of 1992, as amended by Law No. 17 of 2018, defines a brokerage company in contracts as: "The company licensed by the Authority to practice the activity of brokerage and intermediation in the purchase and sale of all types of contracts in the name and for the account of its customers." The natural person working for the brokerage company licensed by the Authority to execute purchase and sale orders for all contracts is called the executor of the order, and the Egyptian Capital Market Law in Article No. 27 limited the work of trading securities within the stock exchange to brokerage companies only and not individuals. These companies are required under Article No. 88 of the executive regulations of the aforementioned law to have their legal personality, as the article stipulates that: "Every stock exchange shall keep a registry of the persons who own the brokerage companies executing transactions on the stock exchange. Registration shall be effected upon a decision by the stock exchange which shall notify the Authority of the registered persons' names within a week of the registration date<sup>5</sup>."

The preceding paragraphs demonstrate that Saudi and Egyptian law agree to limit securities trading in the stock exchange and capital markets to licensed companies rather than individuals.

### • The Importance of Securities Brokerage Companies

There is no doubt that securities brokerage is of unique importance because the securities broker plays a significant role due to its expertise, competence, and full awareness of the conditions of dealing in the capital market. The customers dealing with brokerage companies often lack sufficient experience in dealing in securities. They might be deceived by speculators, or they might not understand the risks involved in dealing in securities, which could cause the customer to lose all of his/her money and others might be reluctant to deal in securities, which has a severe negative impact on the national economy and could impede economic growth.

### 3.1.2. First Topic: What are the forms of manipulation done by securities market brokers:

The securities markets have witnessed manipulation done by some brokerage companies or their agents, which has significantly contributed to the loss of investors' rights and has a detrimental effect on the country's economy. The collapse of the securities market weakens the state's ability to compete economically in international markets. From this standpoint, we will define manipulation and then go over certain types of manipulations that have an impact on the stock market's efficiency.

### • What is the manipulation of securities prices<sup>6</sup>:

In general, the term "capital markets manipulation" refers to activities taken by an individual trader or group of traders to create a false disparity between the price and value of a security to make money off of other traders in the market. The majority of manipulation definitions have come to agree on a precise definition, which is to influence the price of the security up or down in a way contrary to reality. One of these definitions is to adopt illegal means to influence the price of a security to trade at a price higher or lower than the price<sup>7</sup> that results from supply and demand under normal circumstances. The Egyptian Court of Cassation has argued that speculation constitutes price manipulation if it deviates from its economic functions by being used as a tool to dominate prices and change<sup>8</sup> its natural direction by provoking ups and downs. The Egyptian Court of Cassation has also stated in a recent ruling that "price manipulation is any act or omission to influence the trading prices of securities<sup>9</sup>, and that would harm all or some of the customers in the stock market. The Executive Regulations of the Egyptian Capital Market Law issued by Law No. 95 of 1992 defined price manipulation as: "Any act or omission to influence the trading prices of securities, and that would harm all or some of the customers in the stock market."<sup>10</sup>

The first paragraph of Article (49) of the Saudi Capital Market Law describes the one who commits fraud as "Any person shall be considered in violation of this Law if he intentionally does any act or engages in any action which creates a false or misleading impression as to the market, the prices or the value of any Security to create that impression or thereby inducing third parties to buy, sell or subscribe for such Security or to refrain from doing so or to induce them to exercise, or refrain from exercising, any rights conferred by such Security."

<sup>4</sup> See the resolution of the Saudi Committee for Resolution of Securities Disputes No. 1436/L/D1/2014 of 1435 AH dated 17/5/2015 AD, Case No. 159/34, as well as resolution No. 1359/L/D1/2014 of 1435 AH dated 9/7/2014 AD, Case No. 53/35.

(5) Al-Adawi, Jamil, *Stock Exchange in the Balance of Islamic Sharia and Positive Law*, Dar Al-Fikr Al-Jami 'i, Alexandria, Iqbal, Khurshid Ashraf, *Capital Market between Sharia and Positive Laws*; Al-Rushd Library Edition, Riyadh, 2006 Edition.

<sup>6</sup>Article 49 of the Saudi Capital Market Authority Law stipulates that manipulation is "any act or engages in any action which creates a false or misleading impression as to the market, the prices or the value of any Security for the purpose of creating that impression or thereby inducing third parties to buy, sell or subscribe for such Security or to refrain from doing so."

<sup>7</sup> Abdul Rasool, Mohammed Farouk, *Criminal Protection of the Stock Exchange*, Dar Elgamaa Elgadida , Alexandria, 2007, p. 122, Abu Hurairah, Saad , *Manipulation of Financial Markets*, Research submitted to the twentieth session in Makkah Al-Mukarramah (Islamic Fiqh Academy), 2010, p. 2.

<sup>8</sup>(Appeal in Cassation No. 376 of 33 Judicial Year, Session dated 2/5/1967, S.18, p. 931)

<sup>9</sup>(Appeal in Cassation No. 12052 of 90 Judicial Year, Session dated March 1, 2021)

<sup>10</sup> Article 319 of the Executive Regulations of the Capital Market Law No. 95 of 1992.

• **Forms of Securities Prices Manipulation:**

Paragraph (c) of Article (49) of the Saudi Capital Market Law addressed the forms of fraudulent acts as follows:

1. To perform any act or practice aiming at creating a false or misleading impression of existing active trading in a Security as may be contrary to reality. These acts and practices shall include, but not be limited to the following:
  - a. Undertaking transactions in securities that do not involve a true transfer of ownership thereof.
  - b. Entering an order or orders for the purchase of a particular security with prior knowledge that an order or orders of the same size, price, and timing for the sale of the same security has been or will be entered by a different party or parties.
  - c. Entering an order or orders for the sale of a particular Security with prior knowledge that an order or orders of substantially the same size, price, and timing for the purchase of the same Security has been or will be entered by the same party or different parties.
2. To affect, alone or with others, the price of a particular Security or Securities traded on the Exchange through executing a series of transactions in such Security or Securities creating actual or apparent active trading or causing an increase or decrease in the prices of such Securities, to induce third parties to buy or sell such Securities as the case may be.
3. To affect, alone or with others through any series of transactions such as buying or selling or buying and selling security traded on the Exchange to peg or stabilize the price of such Security in violation of the rules set forth by the Authority for the safety of the market and the protection of investors.<sup>11</sup>

• **Individual Methods adopted by Brokerage Companies to manipulate Securities Prices:**

• **Raising the Price of Securities:** A securities price manipulator may strive to boost the price of a particular security or multiple securities in conjunction with its owner. In this situation, the buyer of the security suffers the real price difference from the acquired price.<sup>12</sup>

• **Fixing the price of the securities subject to manipulation:** There may be a sudden drop in the price of the security, so the issuing company resorts to fixing the price of the security to maintain the stability of its price by buying large quantities of the security during this period to give the impression to investors that there is real demand for this security<sup>13</sup>.

• **Deliberate Price Reduction** The speculator may resort to reducing the price of the security, in cases of short selling to obtain the spread.

• **Manipulation of collective agreements** to cause artificial changes in the pricing of securities to achieve profit. Such agreements are concluded between brokerage companies, or in collaboration with some stock exchange workers, or organizations issuing negotiable instruments. There are many forms of collective agreements to manipulate the prices of securities<sup>14</sup>, including:

- **Trading agreements on the part of the securities issuer** try to own as many of the shares issued by the facility as possible, and sometimes this form is done through brokerage companies exploiting the trust of their customers by telling them to buy or sell these shares, so prices decrease and<sup>15</sup> then they circulate stories that contradict what they have promoted, causing prices to rise, and they buy or sell for unlawful profits.<sup>16</sup>The rationale for blocking this form is that it generates unreal profits for the parties to the agreement at the expense of genuine investors, based on fraudulent tactics, as the owners of the securities decided to sell them based on the deceptive information promoted by the parties to the agreement.

- **Futures Manipulation:** Through the agreement of a group of investors to buy all the supply of security before the maturity date, and at the maturity date, the buyers request the transfer of ownership of this security, but the sellers are unable to sell it because of its scarcity, so they are forced to request it from the buyers, so they control the price that does not reflect its true value.<sup>17</sup>

- **Unreal Transaction carried out by Brokers:** This procedure is one sort of fraud prohibited by Article (49/a) of the Saudi Capital Market Law, which states that: "The following acts and practices shall be deemed instances of fraud prohibited under paragraph (a) of this Article: Conducting transactions in securities that do not involve a real transfer of ownership of those securities." In Egyptian law, Article 321 of the Executive Regulations of the Egyptian Capital Market Law No. 95 of 1992 prohibited this by stipulating that "it is prohibited to exercise an influence over the market, or prices, with any dealing through carrying out transactions that do not lead to a change in the actual beneficiary."

It is obvious from the above that Saudi law and Egyptian law ban any type of trading that does not result in a change in the beneficiary's ownership, i.e., it does not result in a real transfer of ownership.<sup>18</sup>

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((11Taha , Mustafa Kamal , Securities Exchanges/National Center for Legal Issues, 2018 , Mouawad, Nadia Mohammed, the Role of Securities Brokerage as Trading Brokers, Dar Al Nahda Al-Arabiya, 2004.

//((12Abdul Rasul, Muhammad Farouk, *ibid.*, p. 124.

(13) Hindi, Munir Ibrahim, *ibid.*, p. 90, Al-Hulaibi, Osama Adnan, the Legal Responsibility of the Broker for Stock Exchange Transactions, PhD Thesis , Faculty of Law, Cairo University, 2013.

((14 Qashqosh, Huda Hamed, the Criminal Protection of Online E-commerce, Dar Al-Nahda Al-Arabiya, 2000 Edition.

((15Abdul Latif, Mohamed Mahmoud Hamdi , Legal Problems Associated with Securities Trading, PhD Thesis, Cairo University, Faculty of Law, 2014 , p. 211.

((16Nematallah, Hassanah Hamed, Securities Markets, PhD Thesis, Faculty of Law, Mansoura University, 2005

17 Al-Hamrani, Saleh Rashid, the Role of Brokerage Companies in Securities Exchange according to the Law No. 95 of 1992, PhD Thesis, Faculty of Law, Cairo University, 2000.

18 El Sayed, Ismail Abdel Aal, New Tools and Policies in Securities Markets, PhD Thesis, Faculty of Law, Cairo University, 2008, p. 520, Al-Ahwani, Hussam Al-Din, the Responsibility of Brokerage Companies towards their Customers under the Capital Market Law, research submitted to the Conference of the Faculty of Law in Sharjah, 2004.

– **Pre-arranged Trading between Brokers:** Article (49/b) of the Saudi Capital Market Law stipulates that the following acts and practices shall be deemed instances of fraud prohibited under paragraph (a) of this Article: Entering an order or orders for the purchase of a particular security with prior knowledge that an order or orders of the same size, price, and timing for the sale of the same security has been or will be entered by a different party or parties.”

This type is done by entering identical buy and sell orders at the same time on a certain security to several brokers under prior agreement between them to create a false impression of the opportunities to make profits when trading this security and help to promote it. Investors buy without selling and prices rise and then fall and benefit from <sup>19</sup>the price difference. This type of virtual trading undoubtedly affects the price of the security in question unless it is between a holding company and another subsidiary, which agreed mutually to transfer ownership of a quantity of securities from one company to another<sup>20</sup>. The reason for criminalizing this type of manipulation is that it is a type of uncompetitive speculation that leads to deceiving customers in terms of the real price of trading.

– **The Brokerage Company Dealing for its Account**<sup>21</sup>: The company may discover that the issuing company has generated profits on specific securities, or that there are large offers to buy certain securities, resulting in a price increase soon. The brokerage company promptly purchases the paper for itself and then performs a fraudulent sale until it profits from the price difference. On the contrary, if the brokerage company learns about the company's vulnerability to a violent financial shock, huge sale orders on this paper will be placed as soon as the dealers are aware of this information, resulting in a price fall. The brokerage company completes the sale transactions before the customer issues his order to sell, and when prices fall, it purchases from the market at a cheap price, generating a capital profit from the difference between the sale and the purchase.

– **Brokers make transactions based on non-public information**<sup>22</sup>: The prices of securities are greatly affected by the information received by brokerage companies from the issuing company, and this information may not be available to the public. Brokerage companies earn from trading this company's securities before the general public becomes aware of them, particularly in futures contracts.<sup>24</sup> Brokerage companies certainly have abundant information about the securities in circulation that investors do not know about on the stock exchange, and this information has a significant impact on the price of the security related to the information, either positively or negatively, and the employees of the brokerage company exploit this internal information in trading or disclose it to other people who are not familiar with it, which violates the principle of transparency, disclosure, and exploitation of information for their account or the account of some investors, As a result, some suffer losses while others gain. Therefore, Article No. 64 of the Capital Market Law prohibits using the internal information, which stipulates the following: “Without prejudice to any severer penalty stipulated in any other law; imprisonment for a term not less than two years, and a fine of not less than Twenty Thousand Pounds (L.E. 20,000), and not exceeding Fifty Thousand Pounds (L.E. 50,000), or either penalty, shall be inflicted on any person who divulges a secret, which is in his possession under his duties under government by the provisions of this law or has benefited, he, his spouse and his children, from insider information of his work, or who used material misstatement or omitted any material information in reports, submitted by him, to the extent that it affects the results contained in such reports. The Article No. 322 of the Executive Regulations of the same law states that an Insider shall, under their offices, or the nature of employment, be prohibited from abusing such information for their interest, or the interest of a third party, or disclosing, directly or indirectly, such information to a third party. Article No. 323 of the Executive Regulations of the same law states that: "Disclosing secrets of customers' accounts and transactions or carrying out anything to cause damage to the interest of a customer or other parties shall be prohibited. Any dealing in a security by a person who has, directly or indirectly, accessed material information related to it, and knows that such information exists but is not made public, shall be prohibited. Insiders shall be prohibited from disclosing inside information to a third party unless the third party is vested with a legal authority empowering him to have access to such information."

– **Breach of trust and Abuse of Customer Trust:** If the brokerage companies are commercial companies aimed at achieving profit, but the ambitions of those in charge may deviate to betray the trust of the customers contracted with them to gain illegal profits from the commission by selling or buying the customers' shares without their knowledge and consent if the customer delegates and authorizes the brokerage company to trade the securities he/she owns, so they sell or buy without explicit orders from them or without referring to them, which is a betrayal of the trust they were granted<sup>25</sup>.

19 Meshaal, Abdul Bari, Manipulation of Stock Markets, research presented to the 20th Session of the Islamic Fiqh Academy in Riyadh, May 2010.

<sup>20</sup> Abdullatif, Ahmed Saad, Investment Strategies and Policies, 2004, p. 482.

<sup>21</sup>The Article (49/c) of the Saudi Capital Market Law stipulates that the following acts and practices shall be deemed instances of fraud prohibited under paragraph (a) of this Article: "To affect, alone or with others, the price of a particular Security or Securities traded on the Exchange through executing a series of transactions in such Security or Securities creating actual or apparent active trading or causing an increase or decrease in the prices of such Securities, to induce third parties to buy or sell such Securities as the case may be."

<sup>22</sup> Al-Qahwaji, Ali Abdul Qadir, Criminal Protection of Electronically Processed Data, research submitted to the College for Islamic Sharia and Law (Dubai), 2000.

<sup>23</sup> Article (50/b) of the Saudi Capital Market Law stipulates that: It is prohibited for any person to purchase or sell a security based on information obtained from an insider while knowing that such person, by disclosing such inside information relating to the security, has violated the provision of paragraph (a) of this Article.

<sup>24</sup> Eid, Adel Abdel Fadil, the Contract for the Sale of Securities in the Stock Exchange, Dar Al-Nahda Al-Arabiya, 2007, p. 55.  
<sup>25</sup>Ahmed, Abdul Fadil Mohammed, Stock Exchanges, research submitted to the Journal of Legal and Economic Research, Faculty of Law, Mansoura University, Issue No. 4, 1988, p. 11.

• **Position of Egyptian law<sup>26</sup> and Saudi law<sup>27</sup> towards manipulating the prices of securities:**

The Egyptian legislator and the Saudi regulator agreed to make manipulating securities prices illegal, and individuals who do so will face a five-year prison sentence. Egyptian law requires a fine of at least fifty thousand pounds and a maximum of one hundred thousand pounds, or one of these two punishments. In contrast to Egyptian law, Saudi law did not establish a minimum or maximum compensation amount.

**3.1. 3. Second Topic: Broker's Civil Liability to Customers**

Brokerage companies are classified as commercial companies and must follow the standards for demonstrating commercial matters. Compensation for brokerage companies' errors is subject to professional error because a professional company's employees have the expertise and competence that the legislator requires when founding brokerage companies and throughout their lifetimes. Brokerage companies are the sole monopolists in the stock market. The investor or his representative cannot trade securities on the stock exchange.

Brokerage company violations are criminal, civil, and administrative violations, resulting in criminal fines, civil liabilities, and disciplinary and administrative sanctions. We will limit our research to civil liability issues.

• **Civil Responsibility:**

Brokerage companies are civilly accountable to customers for any breach of their duty to customers that causes damage, regardless of whether the breach is contractual or tortious. The brokerage company is accountable for contractual liability whenever it breaches one of its contractual commitments, such as when it violates customer orders for sale or buy. It is also liable for tort if there is damage to the customer due to an error outside the scope of the implementation of the contract concluded between them. The contractual liability in the securities brokerage contract is the same as the contractual liability in contracts binding on both sides so that each party has several reciprocal obligations. It is also assumed that there is a contractual bond between the aggrieved party and the one who causes the damage. As for tort liability, it assumes that there is a tortious fault committed by the company towards the customer.

Civil liability, whether contractual or tortious, must be based on three elements under the rules of civil liability in the provisions of the Civil Code, which are error, damage, and causal relationship. We will explain each element with an indication of the difference between contractual and tort liability and its impact on compensation<sup>28</sup>.

• **First Pillar: Error:**

The pillar of error is the basis of the company's liability towards customers so that if an error is available, the judge examines the amount of compensation according to whether it is a minor or serious error and the amount of damage suffered by the customer after it is proven that there is a causal relationship between the error and the damage.

Regarding brokerage companies, they are legal persons who are asked about the errors of their employees under the rules of liability followed for the actions of their subordinates, as well as the broker is asked about the actions of its agents<sup>29</sup>, **and the errors that can be committed by brokerage companies are many and result in damages to the customer, including some common examples in the Egyptian and Saudi stock markets:**

**1-Disclosure of customer secrets** through the brokerage company disclosure of the securities that the customer wishes to deal in by sale or purchase, which exposes him to financial losses. The broker's disclosure of the secrets of its customer is considered a violation of civil liability. Under the contract between the brokerage company and the investor<sup>30</sup>, the brokerage

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<sup>26</sup> Article 63/6 of the Egyptian Capital Market Law No. 95 of 1992 stipulates that: Without prejudice to any severer penalty stipulated in any other law; imprisonment for a term not exceeding five years, and/or a fine of not less than Fifty Thousand Pounds (LE. 50000), and not exceeding One Hundred Thousand Pounds (LE. 100000); shall be applied to Any person quoting artificial price of a security, or conducting a false transaction, or attempted by fraud to affect market prices”.

<sup>27</sup> Article 57/C of the Saudi Capital Market Law issued by Royal Decree No. M/30 dated 2/6/1424 stipulates that: “(a) Any person who violates Article 49 of this Law or any of the regulations or rules issued by the Authority according to said Article by engaging in an act or transaction for the purpose of intentionally manipulating the price of a security or participating in such act or transaction or is responsible for another person who undertakes such act or transaction shall be liable for damages to any person who purchases or sells the security whose price has been significantly and adversely affected by such manipulation for the amount such person’s purchase or sale price was so affected. (b) The damages recoverable under this Article from any defendant, and the rights of compensation and its distribution among the persons responsible shall be determined in a manner that is consistent with the provisions of paragraph (e) of Article 55 of this Law. (c) In addition to the penalties and financial compensation provided for under this Law, the Committee may, based on a claim filed by the Authority, punish the persons who violate Articles 49 and 50 with imprisonment terms not exceeding five years.”

(28) Sabih, Mahmoud, *Financial and Economic Analysis of Capital Markets*, 1995, p. 144.

<sup>29</sup>Mouawad, Nadia Mohammed, *the Role of Securities Brokerage as Trading Brokers*, *ibid.*, p. 33.

<sup>30</sup> Article 64 of the Egyptian Capital Market Law No. 95 of 1992, as amended by Law No. 123 of 2008, stipulates that: "Imprisonment for a term not less than two years, and a fine of not less than Twenty Million Pounds (LE. 20,000,000), or either penalty, shall be inflicted on any person who divulges a secret, which is in his possession by virtue of his duties under government by the provisions of this law, or has benefited, he, his spouse and his children, from insider information of his work, or who used material misstatement, or omitted any material information in reports, submitted by him, to the extent that it affects the results contained in such reports, or deals in securities in violation of the provisions stipulated in Article 20 bis

companies are considered custodians of the secret as if the investor entrusted the brokerage company with his desire to buy a large deal of securities. The disclosure of this desire harms the investor, as this may lead to an increase in the value of the security to be purchased, which causes damage to the interest of the customer.

**2- Breach of failure to disclose Information to Investors:** Brokerage companies are professional companies specialized in trading securities with their experience and knowledge of all transactions in the capital market, one of their tasks is to inform investors before making their decisions to sell or buy securities and provide them with all information related to the deal to be executed before executing the deal and on time<sup>31</sup> sincerely and honestly, where the investor's decision is based on free and conscious will. They must also make statements after the completion of the deal whenever the brokerage company becomes aware of the market situation or the obstacles that hinder the completion of the deal.<sup>32</sup>

It is clear from the above that the brokerage company's commitment to disclose information is automatic because the investor's duty of trust requires it to make all statements before contracting, during the execution of the deal, and throughout the implementation of the contract concluded between them. If it breaches this commitment, it bears responsibility<sup>33</sup>.

• **Second Pillar: Damage:**

The damage is the main reason for civil liability, whether it is contractual or tortious, and the damage may occur to the investor due to the brokerage company's failure to provide information to the investor, or making incorrect statements that lead to the investor deciding on the transaction in question that leads to a financial loss, or as a result of the delay in executing the investor's orders to sell or buy. This is regulated by the Saudi Capital Market Law, which stipulates in Article (56)<sup>34</sup> the responsibility of the brokerage company to compensate for the damage caused by the error of stating incorrect data or hiding facts from the investor, which if known by him the purchase price will be impacted, but the Egyptian legislator did not regulate the liability of the brokerage company for the damage caused to customers, whether in the Capital Market Law, the executive regulations, or executive decisions, which requires reference to the general rules of the provisions of contractual or tortious liability in the Civil Code. The damage to be compensated is not limited to the material damage but it extends to the moral damages. However, Article (56) of the Saudi Capital Market Law mentioned the liability for material damage and did not address the moral damage.

**Material Damage** is "any breach of a financial interest of the aggrieved party, whether the loss or the loss of a profit"<sup>35</sup>, and the realization of material damage is subject to several conditions, the most important of which are:

**1- Damage Realization:** If the brokerage company makes a mistake in the execution of the customer's orders, delays in their execution, or does not take into account the duty of trust and care for the interests of the investing customer and this leads<sup>36</sup> to cause loss for the customer. So, the customer has the right to claim the brokerage company for compensation for the material damages suffered, for example, lack of prudence in purchases, as if the investor did not know that the investment is owned by a company threatened with bankruptcy<sup>37</sup>.

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of this law," as well as Article 56/a of the Saudi Capital Market Law stipulates that: "Any person who makes, or is responsible for other person making, orally or in writing an untrue statement of material fact or omits to state such material fact, if it causes other person to be misled in relation to the sale or the purchase of a Security, shall be liable for compensation of the damages. For establishing responsibility for damages in pursuance of the provisions of this Article, it is not required that a relationship exists between the claimant and the defendant, and the claimant must prove: That he was not aware that the statement was omitted or untrue, that he 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 Security at the price at which such Security was purchased or sold, or 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."

<sup>31</sup> Article 12 of the Executive Regulations of the Saudi Capital Market Law stipulates that: "The capital market institution or the registered person must execute customer orders on a security before executing any order relating to the same security for the account of either of them." As well as Article 13 of the aforementioned regulation stipulates that: "If a capital market institution accepts a customer order or decides at its discretion to execute a customer order, it must execute the order as soon as it becomes practical in the prevailing circumstances."

<sup>32</sup> Al-Mahdi, Nazih Sadiq, Commitment before contracting to make statements related to the contract and its applications to some types of contracts, Sources of Commitment, Dar Al-Nahda Al-Arabiya, 1998, p. 312 et seq.

<sup>33</sup> Ismail, Muhammad Sadiq, Arab Stock Exchanges between Development and Future Challenges, Al-Arabi Library for Publishing and Distribution, 2016.

<sup>34</sup> Article 56/a of the Saudi Capital Market Law stipulates that: "Any person who makes or is responsible for another person making, orally or in writing an untrue statement of a material fact or omits to state such material fact, if it causes another person to be misled concerning the sale or the purchase of a Security, shall be liable for compensation of the damages. For establishing responsibility for damages in pursuance of the provisions of this Article, it is not required that a relationship exists between the claimant and the defendant, and the claimant must prove."

<sup>35</sup> Al-Sadda, Abdul Moneim Faraj, the General Theory of Commitment, Dar Al-Nahda Al-Arabiya, 1991, p. 385.

<sup>36</sup> Articles 13, 14, 15, and 16 of the Executive Regulations of the Capital Market Law, p. 18 -19.

<sup>37</sup> Mahmoud, Shaaban Ahmed, Explanation of the Provisions of the Capital Market Law - Dar Al-Nahda Al-Arabiya, 2009, Mouawad, Nadia Mohammed, the Role of Securities Brokerage as Trading Brokers, *ibid.*, p. 99.

**2- The damage caused to the customer is a direct effect of the error of the brokerage company:** The company is held accountable for projected damages, but if it is demonstrated that the brokerage company committed a severe error or acted in bad faith, it is held accountable for both expected and unforeseen damages.

Article 221/2 of the Egyptian Civil Code stipulates the following: "If the obligation is established by the contract, the debtor who has not committed fraud or serious error shall only be obligated to compensate for the damage that could have been expected at the time of contracting." Article (55/e) of the Saudi Capital Market Law stipulates that: "With consideration to the provisions of paragraph (d) of Article 59 of this Law, damages may be obtained through a claim brought based on paragraph (a) of this Article, and such damages shall represent the difference between the price 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 bringing the claim or the price which such Security could have been disposed of on the Exchange before filing the claim with the Committee."

Brokerage companies are considered commercial companies. Therefore, the company is held accountable for compensation from the time of the occurrence of the damage, and not from the time of judgment proving it. It proves the investor's right to be compensated as soon as it is realized, even if no judicial ruling has been issued. Therefore, the investor has the right to intervene in bankruptcy if the company is declared bankrupt and he/she is also entitled to require compensation from the insurance company if the brokerage company has concluded insurance contracts on the transactions it conducts.

• **Third Pillars: Causal Relationship:**

The causal relationship between the harmful act and loss is one of the main elements of civil liability, and compensation for investor losses is subject to proving the causal relationship between the brokerage company's error and the damage caused to the customer so that it is proven that the brokerage company's error regarding the deal that concluded the contract caused him material or moral damage (Shamsollahi, 2021), so the customer is not entitled to compensation if the brokerage company proves the interruption of the causal relationship between its activity and the damage that harmed the customer.

**The causal relationship between the company's activity and the damage is interrupted if one of these cases is present<sup>38</sup>:**

**1. The Customer's Error** may cause damage to himself, and his error may prevail over the brokerage company's error, such as alerting the investor to the possibility of suffering a loss if he/she took the initiative to buy or sell a particular security. However, he/she insisted on completing the process and a loss occurred due to the lack of causation. If the error was shared between the brokerage company and the investor<sup>39</sup>, each of them was responsible to the extent of his error<sup>40</sup>, and the brokerage company bears its percentage of compensation to the extent of the error it committed.

**2. Third Parties Error:** A third party may cause harm to the investor, such as the error of the exchange's employees or the error of the central depository and custody staff in settling the deal, which resulted in harm to the investor, so the brokerage company is not accountable, but the one who caused the harm is accountable<sup>41</sup>.

**3. Foreign Cause:** Unexpected matters may happen for the brokerage company during the execution of the transaction assigned by the customer, and it cannot be avoided. Therefore, the brokerage company had no involvement in creating harm to the customer.

Accordingly, the brokerage company shall be held accountable for all violations committed under the provisions of contractual liability. If the company commits a serious violation or a deliberate mistake, it shall be held accountable under the provisions of tort liability.

• **Compensation Provisions under the Saudi Capital Market Law:**

Article 56 of Royal Decree M30 issued on 2/6/1424 AH stipulates that:

"1. Any person who makes, or is responsible for another person making, orally or in writing an untrue statement of a material fact or omits to state such material fact, if it causes another person to be misled concerning the sale or the purchase of a Security, shall be liable for compensation of the damages. For establishing responsibility for damages in pursuance of the provisions of this Article, it is not required that a relationship exists between the claimant and the defendant, and the claimant must prove:

(a) That he was not aware that the statement was omitted or untrue.

(b) That he 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 Security at the price at which such Security was purchased or sold.

(c) 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.

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<sup>38</sup> Article 55/e of the Saudi Capital Market Law stipulates 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 that is the subject of the claim, such portion shall be excluded from the damages for which the defendant is responsible."

<sup>39</sup> Abu Talib, Salah Amin, *The Role of Brokerage Companies in the Sale of Securities*, Ibid., p. 211.

<sup>40</sup> Article 196 of the Civil Code stipulates that: "If there are multiple persons are responsible for a harmful act, they were jointly committed to indemnify the damage and liability shall be among themselves equally, only if the court designates share of each in the indemnity."

<sup>41</sup> Eid, Adel Abdel Fadil, *Brokerage in Islamic Jurisprudence and Contemporary Applications*, Ibid., p. 66.



2. The damages recoverable under this Article from any defendant, and the rights of compensation and its distribution among the persons responsible shall be as provided in paragraph (e) of Article 55 of this Law.<sup>42</sup>

3. For purposes of this Article, a statement or omission shall be considered related to an important material fact under the standard provided for in paragraph (a) of Article 55 of this Law<sup>43</sup>."

Article 57 of the same decree stipulates that:

"(a) Any person who violates Article 49 of this Law or any of the regulations or rules issued by the Authority according to said Article by engaging in an act or transaction to intentionally manipulate the price of a security, or participate in such act or transaction, or is responsible for another person who undertakes such act or transaction shall be liable for damages to any person who purchases or sells the security whose price has been significantly and adversely affected by such manipulation for the amount such person's purchase or sale price was so affected. (b) The damages recoverable under this Article from any defendant, and the rights of compensation and its distribution among the persons responsible shall be determined in a manner that is consistent with the provisions of paragraph (e) of Article 55 of this Law.

As for compensation for moral damage, it can be compensated if the brokerage company's error caused a significant financial loss that affected its financial and moral reputation, whether due to contractual or tort liability<sup>44</sup>.

#### 4. Results

- Brokers have an important role in the Saudi and Egyptian capital markets, as they require that transactions within the capital market be carried out by brokers, otherwise dealing in securities is void.
- There is an agreement between the Saudi regulator and the Egyptian legislator to limit brokerage in the capital market to legal persons (companies) and not individuals.
- There is a clear distinction in penalties between Saudi law and Egyptian law, as we see that the Saudi regulator rarely resorts to imprisonment in these crimes, instead preferring fines and other penalties, whereas the Egyptian legislator frequently resorts to imprisonment, whether harsh or mild, against those crimes.
- The Saudi Capital Market Law has defined the necessary compensation in the case that brokers influence the values of securities, in contrast to the Egyptian legislator, who left compensation to the judiciary's discretion. However, the Egyptian legislator has implemented preventative steps to prevent brokers from manipulating, in contrast to the Saudi Capital Market Law, which lacks administrative responsibility rules and imposes precautionary measures.
- The Saudi Capital Market Law included provisions regulating the trading of securities within the market to prevent manipulation that harms the market's customers and protect the economy from collapse.
- There is a correlation between brokers' manipulation of securities prices due to weak control over the business of securities brokers, the failure to deal with investor complaints, and the exit of many small investors from investing in securities.

#### 5. Recommendations

- The obligation to impose severe criminal penalties for intentional crimes and to increase the fine for unintentional crimes, as well as granting civil reparation for those who have suffered harm as a result of brokerage companies' errors.
- Informing everyone in the market about all daily transactions after contracting with the brokerage company to determine the timing of execution of the customer's order.
- Holding educational legal courses that clarify the mechanisms of dealing with the capital market and capital brokers, to spread the legal culture of the capital market and deal therewith.

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<sup>42</sup>Article 55, paragraph (e): "With consideration to the provisions of paragraph (d) of Article 59 of this Law, damages may be obtained through a claim brought based on paragraph (a) of this Article, and such damages shall represent the difference between the price 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 bringing the claim or the price which such Security could have been disposed of on the Exchange before filing the claim 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 that is the subject of the claim, such portion shall be excluded from the damages for which the defendant is responsible. The defendants are individually and jointly liable for damages for which they are responsible under this Article. The compensation amount shall be subject to the provisions of the contract or agreement entered into between the parties identified in paragraph (b) of this Article or as the Committee deems equitable and does not harm the interests of investors or otherwise contradicts the objectives of this Law.

<sup>43</sup> If the prospectus includes when approved by the Authority ..... A statement or omission shall be considered material for 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.

<sup>44</sup> Al-Hulaibi, Osama Adnan, *The Legal Responsibility of the Broker for Stock Exchange Transactions*, *Ibid.*, p. 188.

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