THE LAW OF MARKET MANIPULATION IN SAUDI ARABIA:

A CASE FOR REFORM

A Thesis Submitted for the Degree of Doctor of Philosophy in Law

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DECLARATION

I declare that the work presented in this thesis is my own except where it is stated otherwise.

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ABSTRACT

The integrity of financial markets is threatened by a number of harmful practices. These are often generally described as 'market abuse'. Market abuse comprises two practices: insider dealing and market manipulation. This thesis mainly explores market manipulation and the relevant Saudi law. Market manipulation was first regulated in 2003.[1] It is therefore possible and useful for the purposes of this thesis, to distinguish between the pre- and post- enactment periods.

This study has four main objectives. First, it will define market manipulation and describe its most common forms. Secondly, it will assess the application of Saudi civil and criminal law to market manipulation prior to the enactment of the Capital Market Law 2003. Thirdly, it will critically evaluate the application of this law to the different forms of market manipulation. Finally, it will assess how well the 2003 law is enforced. Different methodologies have been used to achieve these objectives with a focus on critical analysis and comparative study. The author has used the well-established US Securities Exchange Commission (SEC) and the UK Financial Services and Markets Act 2000 to evaluate the Capital Market Law 2003. Prior to the enactment of this law, there were almost no regulations dealing with market manipulation.

The 2003 law is applicable to most forms of market manipulation with the exception of security price stabilization and forms manipulation. Penalties under Saudi civil law tend to be more lenient compared to the US and the UK and this may inhibit its deterrent effect. Also, Saudi judges generally tend to lack the necessary understanding of manipulative practices to enforce the law effectively. Therefore, the success of the 2003 law in deterring and punishing manipulative practices should be reassessed in a few years' time, when there is more data to make an accurate evaluation.

Keywords: *Insider dealing, Islamic law, Market abuse, Market manipulation, Regulation.*

[1] Capital Market Authority, *'Annual Report 2007'* (Capital Market Authority 2007) 16.

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LIST OF ABBREVIATIONS

ADR	Alternative Dispute Resolution
AML	Anti-Money Laundering
CCFI	Consulting Centre for Finance and Investment
CFTC	Commodity Futures Trading Commission
CMA	Capital Market Authority
CML	Capital Market Law
CSA	Central Share Account
DTI	Department of Trade and Industry
ECHR	European Convention of Human Rights
ESIS	Electronic Securities Information System
FCA	Financial Conduct Authority
FERC	Federal Regulatory Commission
FIU	Financial Intelligence Unit
FSA	Financial Services Act
FSMA	Financial Services and Markets Act
FTC	Federal Trade Commission
GCC	Gulf Cooperation Council
IFRS	International Financial Reporting Standards
IPO	Initial Public Offering
LIBOR	London Interbank Offered Rate
LSE	London Stock Exchange
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
MCR	Market Conduct Regulations

NCFEI	National Centre for Financial and Economic Information
NYSE	New York Stock Exchange
PBUH	Peace be upon him
S&P	Standard & Poor
SAR	The currency of Saudi Arabia
SAMA	Saudi Arabian Monetary Agency
SEA	Securities and Exchange Act 1934
SEC	Securities Exchange Commission
SFO	Serious Fraud Office
SJC	Supreme Judicial Council
SOX	Sarbanes–Oxley Act of 2002
SSRC	Saudi Share Registration Company
TASI	Tadawul All Share Index
XBRL	Extensible Business Reporting Language

GLOSARY

Addlah	Justice
Ahad	Solitary hadith transmitted through a single chain of individuals.
Al-estisna(Istisna'a)	A contract of sale of specified goods that have to be manufactured before delivery is possible. A forward sale; literal meaning, to manufacture or build.
Al-Mustarsil	A person who does not haggle over the price in the market or who does not know how to bargain.
Almuwadha	A contract of exchange in which compensation is given against the goods or services received.
Al-Najash	Prohibited practice of deceiving and inciting a potential buyer of goods during the course of pre-sale negotiations or bidding to secure a greater value that the true worth of the goods.
Al-Taqreer	Uncertainty, hazard, chance or risk.
Amanat	The things entrusted to you
Ayah	A verse or passage in the *Qur'an*.
Block the pretexts (or excuses)	Blocking any excuse that leads to committing forbidden things under Islamic law.
Caliph	Representation; Rule by representation.
Darar	Legal term meaning harm, prejudice, or cruelty
Dirham	Name of a currency unit, usually a silver coin, used in the past in several Muslim countries. The term is still used in some Muslim countries, such as Morocco and United Arab Emirates.
Fatwa	Legal or religious opinion by a ruling on a point of Islamic law given by a qualified Islamic juris consult.
Fiqh	Islamic Jurisprudence.

Ghobn	Misappropriation or defrauding others in respect of specifications of the goods and their prices.
Hadd	Limits; The fixed punishments for certain crimes under Islamic law.
Hadith	Saying; Traditions of the Prophet Muhammad.
Halal	That which is permissible by the Shari'ah, valid earnings.
Hanafi	One of the four well-known schools of thought in Islamic jurisprudence or religious law engaged in the interpretation of the Qur’an and the Sunnah. Founded by one of the classical jurists, Imam Abu Hanifa.
Hanbali	One of the four well-known schools of thought in Islamic jurisprudence or religious law engaged in the interpretation of the Qur’an and the Sunnah. Founded by one of the classical jurists, Imam Ahmad Hanbal.
Haram	Unlawful in Islam.
Hijra	The journey of Muhammad and his followers from Mecca to Medina in June 622 CE
Ihsän	Benevolence; Goodness
Ijmä'	Islamic legal consensus.
Ijtihäd	Juridical reasoning of a qualified Islamic legist.
Ikhtilaf	Legal term meaning differences of opinion were a source of intellectual wealth, they reasoned, that ought to be utilized for the benefit of the whole community.
Istihsän	Juristic preference.
Istisläh	Welfare; Benefit.
Madhhab	Each of the schools of Islamic law, each of which is based on a particular system of interpretation of Islamic religious and legal texts.

Maliki	One of the four well-known schools of thought in Islamic Jurisprudence or religious law engaged in the interpretation of the Qur’an and the Sunnah. Founded by one of the classical jurists, Imam Malik Ibn Anas.
Ma-rifa’	Knowledge.
Maslahah	Welfare; Benefit.
Maslahah Mursalah	Public Interest.
Murabahah	Sale on mutually agreed profit. Technically a contract of sale in which the seller declares the purcahse cost and profit.
Qada	Judgement.
Qadi	Judge.
Qisas	Offences are against the person such as murder, manslaughter and battery
Qiyäs	Legal analogy.
Sadakah	Donations.
Sadd al-dhara'i'	The tools or justifications to attain a goal.
Shafi'i	One of the four well-known schools of thought in Islamic jurisprudence or religious law engaged in the interpretation of the Qur’an and the Sunnah. Founded by one of the classical jurists, Imam Abdullah Muhammad ibn Idris al-Shafi'i.
Shari `ah	The Right Path; Qur'an and the Sunnah. Source of Islamic Law.
Sharikah	Sharing, partner. A contract between two or more persons who launch a business or financial enterprise to make profit.
souht’	Ill-gotten or unlawfully obtained property.
Ta `zir	Discretionary punishment under Islamic law.
Tadlees	Cheating.
Takaful	Guaranteeing each other” or joint guarantee through mutual support and shared responsibility whereby a group of persons

	agree to jointly guarantee among themselves against a defined loss.
Tawlia	Sale (Respective sale):It is selling the commodity for its purchase price without addition or discount.
The Sunnah	Practice; the Practices of Prophet Muhammad. And also might be means: Saying; Traditions of the Prophet Muhammad.
Urf	Custom; Usage; Practice.
Usul al-fiqh	The process of developing evidence to authenticate Islamic law.
Usul-fiqh	The methodology of law or the science of the sources.
Zakät	Annual obligatory alms payable by Muslims in favour of the indigent.

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- *Brady v Brady* [1988] 2 All ER 617
- *Brady v Brady [*1988] BCLC 579

- *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd (1986) BCLC1*
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- *Heald v O'Connor* [1971] 1 WLR 497
- *Ian Hannam v The Financial Conduct Authority* [2014] UKUT 233 (TCC), [2014] Lloyd's Rep FC 704
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- *The King v De Berenger,* 105 Eng Rep 536 (1378-1865)
- *The Mogul Steamship Ltd v McGertor, Gow & Co,* 23 QBD 598 (1889)
- *Winterflood Securities Ltd v Financial Services Authority* [2010] EWCA Civ 42

D. European Court of Human Rights Case:

- *Saunders v UK* (1997) 23 EHRR 313

LEGISLATION

A. Saudi Arabia

- Arbitration Regulation Act 1983
- Anti-Money Laundering Law 2003
- Basic Law of Governance 1992
- Capital Market Law Act 2003

B. US

- CFTC Reauthorisation Act of 2008
- Chicago Board of Trade 1869
- Chicago Board of Trade 1870
- Chicago Board of Trade 1921
- Commodity Exchange Act
- Commodity Futures Trading Commission Act of 1974, PuB L No 93-463, 88 Stat 1389 (1974)
- Dodd-Frank Act 2010
- Insider Trading and Securities Fraud Enforcement Act 1988
- Private Securities Litigation Reform Act 1995
- Rule 10b5-1 of the Securities and Exchange Commission
- Sarbanes–Oxley Act 2002
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- Securities Act of 1933
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C. UK

- Companies Act 1985
- Criminal Justice Act 1993
- Financial Services Act 2012
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CHAPTER 1: GENERAL INTRODUCTION TO THE LAW OF MARKET MANIPULATION IN SAUDI ARABIA: *A CASE FOR REFORM*

1.1 Introduction

It is widely accepted that the Saudi capital market is subject to market manipulation; a belief that is generally pervasive among market investors.[2] While Saudi market manipulation has been the subject of general discussion in newspapers, social media and economic reports, a relative paucity of research within the academic literature has long been apparent, with a similar dearth of material evident in case law. As such, this thesis seeks to address the following question: *What difficulties has the Saudi Capital Market Authority (CMA) faced in addressing market manipulation, and what lessons can be learnt from Islamic Law and the experience of the US and the UK?*

There are four sub-questions that emerge from this:

1. To what extent is the Saudi capital market affected by market manipulation?
2. What is the role of, and what powers does the CMA have in regard to market manipulation?
3. What obstacles does Saudi Arabia face in developing and implementing an effective system that can address market manipulation? How far the Saudi legal system has overcome the obstacles?
4. What lessons can be learnt from the experiences of both the US and the UK and to what degree, if at all, are the tenets of Islamic law applicable in both informing that debate and shaping the direction of proposed actions?

1.2 Research Method

The research methodology employed in this thesis follows two principal approaches: critical analytical and comparative. The first of these, critical analysis, is applied in the review of the different literature forms, as well as in the laws and regulations. These are in addition to the overview provision in the legal structure applicable to

[2] Abdulrahman A Al-Twaijry, 'Saudi Stock Market Historical View and Crisis Effect: Graphical and Statistical Analysis' (Slideshare, 5 July 2010) <http://www.slideshare.net/Zorro29/saudi-stockmarket-historical-view-and-crisis-effect> accessed 20 May 2015.

Saudi market manipulation, and the suggestions made for possible reforms. A comparative approach is apposite in that it allows the researcher to explore and draw on the experiences of both the US and UK markets, and to set these against those which currently pertain in Saudi - the role of Islamic law in the Saudi context will also be examined. One possible benefit to be derived from the use of a comparative approach is the opportunity it confers to explore the specific legal problems currently being addressed in the US and the UK in relation to market manipulation, and whether these or their proposed solutions might readily translate to a Saudi context. Indeed, from a comparative legal standpoint, the questions of legal style and the role played by the interaction of both legal systems and traditions have, of late, enjoyed something of a resurgence of interest.

As John Henry Merryman's notes: 'A legal 'system' is an operating set of legal institutions, procedures and rules' On the other hand, a legal tradition 'is a set of deeply rooted, historically conditioned attitudes about the nature of law, about the role of law in the society and the polity, about the proper organization and operation of a legal system, and about the way law is or should be made, applied, studied, perfected, and taught. The legal tradition relates the legal system to the culture of which it is a partial expression. It puts the legal system in cultural perspective'.[3]

As such, a comparative approach enables the researcher to more fully explore and encompass the myriad facets, which underpin the respective distinctions and similarities, while mindful of the possible negative effects, which may arise when a law is transferred *in toto* from one jurisdiction to another.[4]

In this regard the UK's Financial Services and Markets Act 2000 (FSMA) may usefully serve as a standard in ascertaining whether Saudi Arabia is effectively addressing concerns in relation to market manipulation. One distinct difference, however, is that Saudi does not furnish any support for the legal suppression of manipulation; it is only concerned with evaluating how effective and efficient the system is in handling market manipulation.

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[3] Cited in 'Comparative law and hybrid legal traditions: an introduction' by Sean Patrick Donlan p.2, Available at < http://www.academia.edu/2078774/Comparative_law_and_hybrid_legal_traditions_an_introduction> accessed 13 October 2015.

[4] Otto Kahn-Freund, 'On Uses and Misuses of Comparative Law' (1947) 37(1) Modern Law Review 1.

Although this study adopts a comparative approach, one important caveat should be observed: the thesis focuses primarily on the Saudi experience and that of the CMA; and largely eschews other jurisdictions and experiences save those of the UK and US, as such, it should not be regarded as fully cleaving to a comparative methodological approach. The examination of American and English laws is intended to identify current inadequacies and drawbacks in these respective systems; their similarities to those of the Saudi system lie in their use of all-inclusive security regulations and special authorities responsible for the supervision of their financial markets. In examining how the US and UK authorities deal with any inadequacies given these frameworks, this thesis will consider their applicability and relevance to the Saudi context.

With respect to regulatory authorities, Saudi Arabia looks to the CMA, while the US and UK rely on the Securities and Exchange Commission (SEC) and the Financial Conduct Authority (FCA) respectively. Furthermore, the choice regulation of the US and UK stems from the fact that these two countries have been grappling with issues of regulating market manipulation since 1933. The rationale for selecting the UK as a standard for evaluation is further enhanced by the number of market manipulation cases conducted there. In addition, the UK system incorporates the EU Market Abuse Directive (MAD) and thus falls within the scope of a broader regulatory framework The FCA is mandated with far-reaching authority in enforcing its regulations, conferring on it significant powers of deterrence.

1.3 Research Problem

Although the stock market in Saudi Arabia was one of the first of its kind in the region, it has, however, never been fully regulated.[5] As far as this study is concerned, the development of the Saudi stock market between 1935 and the present day admits of three principal categories, grounded in its structural, operational and regulatory aspects.[6] The first (initial) stage prevailed between 1935 and 1982 and began when the privately owned Arab Automobile Company allowed shares to be made available

[5] Abdullah F Ansary, ‘A Brief Overview of the Saudi Arabian Legal System’ (Hauser Global Law School Program, New York University, 2008) <http://www. nyulawglobal. org/globalex/Saudi_Arabia.html> accessed 24 November 2015.
[6] Aljazira Capital, ‘The Financing Role of the Saudi Capital Market: Promising Prospects’ (Research Department, Economic Reports, 2010) 1.

for public purchase for the very first time. Regulation and governance of the Saudi stock market began with the creation of the Ministerial Committee, made up of the Ministry of Finance and National Economy, the Saudi Arabian Monetary Agency (SAMA)[7] and the Ministry of Commerce, bringing an end to this initial stage. The second stage commenced with the Ministerial Committee's involvement in the stock market and ended in 2002 with the implementation of the Capital Market Law (CML), Royal Decree No (M/30) on 31 July 2003.[8] The modernization (third and final) stage began in 2003 with the Ministerial Committee's enforcement of the CML; this third stage of development persists.[9]

In undertaking a comparative analysis, this thesis will also examine the issue of prosecution under prevailing laws within Saudi, the rights of the accused under the auspices of current applicable legislation and the application of those laws.

Although Islamic law is the primary source of law within Saudi, the enactment of the new Capital Market Law 2003 encompasses many of the provisions of US and UK law in relation to market manipulation. However, while the influence of both UK and US law is evident, there are also clear divergences. One significant concern is whether the principal elements of both US and UK provisions are compatible with the precepts of Islamic law. Where this is not the case, can some form of accommodation between the two be reached?

1.4 Research Objectives

The main objectives of this thesis can be summarized as follows:

1. To define the term market manipulation and identify its different forms as a prerequisite to evaluating the CML.
2. To identify the applicable laws prior to the CML and to evaluate their success in deterring and punishing manipulative practices.
3. To assess the applicability of the CML to the forms of market manipulation identified in point 1.

[7] SAMA is the central bank of Saudi Arabia.
[8] CMA, 'Annual Report 2007' (Riyadh, Capital Market Authority, 2007) 16.
[9] Aljazira Capital (n 6) 1.

4. To evaluate the success of the CML in deterring and punishing manipulative practices.

This thesis will evaluate how well the CML covers the forms of manipulative practices identified and how effective it is in deterring or punishing them. This evaluation will take as a parameter the well-established FSMA.

This research is limited to the Saudi stock market, and is solely concerned with market manipulation and not insider dealing, a subject concerning which the academic literature is replete.

1.5 Literature Review: Establishing the Originality of this Thesis

This research admits of no precursors, as no previous studies exist, which address the regulation of market manipulation in Saudi Arabia. While some studies relating to the stock market generally in Saudi Arabia are available; they do not discuss market manipulation per se.

For example, a PhD thesis presented by Awwad Saleh Awwad details the Legal Regulation of the Saudi Stock Market. However, Awwad's thesis does not specifically deal with market manipulation practices. In addition, a Master's thesis by Turki Al-Otaibi entitled 'The regulation of Market abuse and prohibition of manipulation in the financial markets'. This does not specifically address the problem of market manipulation practices in Saudi Arabia - the research's primary focus being insider dealing rather than market manipulation.

An article by Gouda, Bushra Gouda - 'The Saudi Securities Law: Regulation of the Tadawul, Stock Market, Issuers, and Securities Professionals Under the Saudi' – however, provides an outline of the Capital Market law in Saudi Arabia, and covers in some detail the process of stock offers in the Saudi market. With respect to market manipulation, it further sets out an explanation for regulation in Saudi Arabia. Another article by Ayoub Al-Jarbou 'The Role of Traditionalists and Modernists in the Development of the Saudi Legal System' again omits any mention of market manipulation practices.

In addition, Beach's, 'the Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets'. confines itself solely to an examination and explanation of the Capital Market law, while 'A Brief Overview of the Saudi Arabian Legal System' by Abdullah Ansaary equally foregoes any reference to market manipulation.

In the Arabic literature, *Al-Jarima Wal-Uquba Fe LIslam* (Crime and Punishment in Islam) by Mohammed Abu-Zahra deals with crime in Islamic law in general. A paper by Mohamad Alsuhebani entitled '*Altalaob Fe Alaswaq Almaliya* (Market manipulation in financial markets)' (Seminar of Speculation and market manipulation in financial markets 2008) describes market manipulation and its various forms; however, no details of specific markets or regulations are adduced. In addition, there exists a study by Sa'eed Bo Hawara entitled '*Altalaob Fe Alaswaq Almaliya* (Market Manipulation in Financial Markets)'. This research defines market manipulation and its procedures through an examination of Islamic Law and seeks to determine its applicability to the current conception of market manipulation. A number of other articles also briefly touch on the subject of market manipulation, but either in a very cursory or tangential fashion; chief among these are a short article by Alqahtani M, entitled '*Alnajash*,' 'Engaging in Deceptive Practices in the Stock Exchange by Abdullah Alsulami' and 'Crime in Financial Market' by, Sultan Al-abdulasallam, On the other hand, the literature is replete with studies regarding market abuse and market manipulation with respect to Western markets, since their structures and stock markets are both more developed and of longer standing[10] These previous studies regarding market abuse and market manipulation are addressed in Chapters 4 and 5.

[10] For instance, Markham JW, Law Enforcement and the History of Financial Market Manipulation (Routledge 2014); Seredyńska I, Insider Dealing and Criminal Law Dangerous Liaisons (Springer 2012); Swan EJ and John Virgo, Market Abuse Regulation (OUP 2010); Avgouleas E, The Mechanics and Regulation of Market Abuse (OUP 2005); Abrantes-Metz RM, Rauterberg GV and Verstein A, 'Revolution in Manipulation Law: The New CFTC Rules and the Urgent Need for Economic and Empirical Analyses' (2013) 15(2) University of Pennsylvania, Law School 357; Austin J, 'Unusual Trade or Market Manipulation? How Market Abuse is Detected by Securities Regulators, Trading Venues And Self-Regulatory Organizations' (2015) 1(2) Journal of Financial Regulation 1; Nelemans M, 'Redefining Trade-Based Market Manipulation' (2008) 42(4) Valparaiso University Law Review 1169; Clifford Chance, 'The European Union Market Abuse Directive' (2003) 9(1) Journal of Derivatives & Hedge Funds 1; Goldwasser V, 'Regulating Manipulation in Securities Markets: Historical Perspectives and Policy Rationales' (1999) 5 Austl J Legal Hist 149; Jacobs A, 'Regulation of Manipulation by SEC Rule 10b-5' (1973) 18 New York Law Forum 513; Porterfield PL, 'Securities: Stock Market Manipulation at Common Law and under Recent Federal Securities Legislation' (1940) 28(3) California Law Review 378; Rostow E, 'Market Manipulation and the Securities Exchange Act' (1937) 46(4) The Yale Law Journal 624.

1.6 Research Significance

The impetus for this research owes much to the manipulative practices that have characterized the Saudi capital market to date.[11] Small investors have suffered significant harm and been acutely disadvantaged by the dissemination of misleading information regarding supply and demand and have had no means of redress. The capital market in Saudi Arabia is small, and dominated by a limited number of merchants and investment funds. As such, it has been prone to market manipulation in the absence of a sufficiently robust regulatory framework and authority.[12] Despite this, there are very few recorded cases of manipulative practices. This contrasts with the approach taken in developed markets, where market manipulation is considered to be a crime, and is neither common nor much in evidence, when compared to the situation which persists with respect to the Saudi stock market.[13]

In common with other newly independent countries, Saudi Arabia has had to acquire a measure of experience and undergo various crises before embarking on legal reform. During the Saudi stock market crisis of 2006, the market was badly affected by manipulative practices, including the dissemination of misleading information, high levels of speculation and the execution of artificial transactions.[14] These phenomena significantly affected investors on the Saudi stock market. Unfortunately, no literature currently exists, which deals with these events. It was widely believed that such practices were a normal consequence of freedom of contract. Academics and investors did not appreciate at the time that these types of practices were considered to be both abusive and criminal in developed markets.

Hence, the researcher has chosen to investigate the subject of market manipulation as the very concept is novel in Saudi Arabia and its relevance to the operation of markets not yet clarified by experts. The subject of the thesis is one that is pivotal to economic well-being, as market manipulation has been shown to adversely affect and damage markets globally to a significant degree. Both investors and the market

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[11] Mohammed S, 'Manipulation of financial market: The economic dimension' Imam Mohammed Ibn Saud University (5 March 2008).

[12] Sultan Abdulsalam, Market Manipulation Crime (Muntady Almuhameen Alarab) <http://www.mohamoon.com/montada/Default.aspx?Action=Display&ID=67024&Type=3> accessed 21 October 2015.

[13] ibid.

[14] Mohammed (n 11).

more generally have been detrimentally affected by the lack of regulation on the part of the CMA; omissions and oversights, which precipitated the crisis.[15]

A further consideration is that the Saudi government is particularly keen to transform Saudi Arabia into a commercial and financial hub, and strongly believes that the private sector will be the primary driver of that economic growth as the age of fossil fuels gradually approaches its senescence[16]. The private sector cannot, however, enjoy that necessary fillip if the CMA does not endeavour to address in parallel those gaps and deficiencies, which currently blight market operations. Comprehensive regulations must be enacted to deal with securities transactions, investor protection and market abuse, including market manipulation. In order to achieve the planned privatization program, the legislature will have to enact laws to protect businesses and create a favourable environment for trading through, *inter alia*, securities regulation, so as to facilitate business growth.

This research starts with an evaluation of efforts by the CML at deterring market manipulation. It will then suggest improvements by looking at laws enacted in more mature markets. As market manipulation regulation is increasingly being advocated within legal circles, the author hopes that this research will assist actors in the Saudi market in understanding the dimensions of market manipulation and the rules applicable to it.

A clear understanding of the CML is extremely important to the Saudi market, as confidence and trust in the system are necessary to attract new investments. The author is convinced that the Saudi stock market is, in its present form, not attractive to investors, when compared with more highly regulated and developed markets; a situation, which it could be argued, owes much to the uncertainty arising from the application of the law to, *inter alia*, market manipulation. Such manipulation is still widespread, the result of evident gaps in the legal framework. To date, only a few academics have investigated manipulative practices in the Saudi stock market; in light of this, this thesis may be seen as the first in-depth analysis of market

[15] Legislation conecerning the justice system, particularly with regard to basic rules and provisions in the field of private rights, with its two branches, civil and criminal. In Islamic law, legislation for these fields is based on original Islamic legal texts and scripture such as the Holy Qur'an and the Sunnah (for more details see chapter three, 3.2).
[16] Opec Faces a Mortal Threat from Electric Cars; Ambrose evans-pritchard, <available at http://www.telegraph.co.uk/finance/economics/12065274/OPEC-faces-a-mortal-threat-from-electric-cars.html> accessed 22 November 2015.

manipulation regulation in that market. It must be remembered that the CML is a relatively new concern and should be viewed as representing a first step in regulating market manipulation. This thesis will also propose improvements to the regulation of the Saudi stock market in order that it might come into closer alignment with developed markets.

1.7 Research Structure

This thesis is divided into five chapters in addition to those of the introduction and conclusion.

- Chapter 2, which follows on from this introduction, will investigation the regulation of market manipulation in Saudi Arabia. This chapter will be divided into three sections. The first section deals with the historical development of the CML. The second considers arguments regarding the secular approach of the CML. The third section examines the regulation of market manipulation per se.

- Chapter 3 will provide background information in relation to Islamic law of market manipulation. This chapter has been divided into four sections. In the first section, there is a discussion and description of Islam from a religious and legal perspective. Here, in the context of Islamic law, the Qur'an and the Sunna will be examined as primary Islamic legislative sources; the *Ijma* and the *Qiyas* as secondary Islamic law sources. The second section analyses Islamic objectives. Section three studies whether or not principles of market manipulation supplemented in Islamic law attain their purpose. Finally, a summary is provided.

- Chapter 4 of this study will be cover regulation of market manipulation in the US. The chapter is divided into three sections. The first section deals with the historical basis, showing how manipulative practices have evolved and how these have affected the markets today. The second examines the definition of manipulation under US law. The third section deals with legal developments in US market manipulation law.

- Chapter 5 will in the main cover market manipulation in the UK in its historical setting. It will introduce and cover the various legal statutes enacted to address market abuse, including EU legislation, which either has or may have a significant impact on UK market abuse law.

- Chapter 6 focuses on a comparison of the laws of market manipulation with respect to Saudi Arabia, the US and the UK, it also considers applicable tenets under Islamic law.

- Chapter 7 offers a conclusion and makes recommendations with the aim of reforming market manipulation practices in Saudi Arabia. In this chapter, suggestions are also advanced for future research; identification of the key contributions of the study will be set out in this chapter.

CHAPTER 2: THE SAUDI ARABIAN LAW OF MARKET MANIPULATION

2.1 Introduction

This chapter is crucial to achieving the aim of examining the current Saudi Capital Market Law. This chapter also holds significance, because it will assist the forthcoming research chapters by explaining the functions of the Saudi Capital Market Authority, Saudi Stock Exchange, and the Committees for the Resolutions of Securities Disputes. The central question of this chapter is what the current Saudi Capital Market Law is, and how the Saudi Capital Market Authority works in accordance with the significant regulations that are in place.

Accordingly, this chapter is divided into three sections. The first section deals with the historical development of the Saudi Capital Market Law. The second section deals with the argument concerning the secular approach of the Saudi Capital Market Law. Third section examines the regulation of market manipulation in Saudi Arabia.

2.2 The Historical Development of the Saudi Capital Market Law

The historical origin of the Saudi capital market dates back to 1935 when the Arab Automobile Company's shares went public for the first time.[1] Since then, the development of the Saudi stock market can be classified into three stages based on its structural, operational and regulatory aspects.[2] The first stage is the period 1935-82, and began with the private shares of the Arab Automobile Company being made available for public purchase in Saudi Arabia for the first time in 1935.[3] This stage ended with the rise of Saudi stock market regulation and governance in 1982 by the newly formed Ministerial Committee, comprising the Ministry of Finance and

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[1] Capital Market Authority, *Investing in the Stock Market* on 2/6/1424H (31/7/2003) <http://www.cma.org.sa/En/Documents/IA/Booklet_2.pdf> accessed 28 October 2014.

[2] Awwad Saleh Awwad, 'Legal Regulation of the Saudi Stock Market Evaluation and Prospects For Reforms' (PhD thesis, University of Warwick 2000) 29–30; Aljazira Capital, 'The Financing Role of the Saudi Capital Market: Promising Prospects' (2010) Research Department, Economic Reports 1.

[3] Henry T Azzam, The Emerging Arab Capital Markets (Kegan Paul International 1997) 141; Abdulrahman A. Al-Twaijry, 'Saudi Stock Market Historical View and Crisis Effect: Graphical and Statistical Analysis' 2010 <http://www.slideshare.net/Zorro29/saudi-stock-market-historical-view-and-crisis-effect> accessed 28 October 2014.

National Economy, the Saudi Arabian Monetary Agency (SAMA)[4] and the Ministry of Commerce. The second stage, by far the most established one, began with the Ministerial Committee's 1983 formulation of the Saudi stock market and ended with the Capital Market Law (CML) in 2002, issued under Royal Decree No M/30 on 31 July 2003.[5] The third stage was a modernized one and began with Capital Market Authority attempting to enforce the CML in 2003, which still remains in place today.[6] The following three subsections present some essential aspects of each of the three developmental stages.

2.2.1 The First Stage (1935–1982)

Developing capital market was not at the top of the Saudi government's agenda.[7] In consequence, the Saudi stock market had an informal and primitive nature in the beginning. Two factors hindered the advancement of stock market during this phase. First, this initial stage coincided with the early developmental phase of the Saudi economy. During that time, the primary economic objectives were to build the infrastructure, develop human resources and increase Saudi citizens' standard of living. Thus development of the stock market had been the main focus. Secondly, the discovery of massive oil resources meant that Saudi Arabia was endowed with an enormous amount of wealth in a short period of time. The government in Saudi Arabia was the owner of the oil revenues, and it thus created special credit institutions to channel interest-free loans to the corporate sector. Therefore, the stock market was not the main source of funds for the corporate sector, and consequently, little attention was paid to advancing the stock market.[8]

The initial stage was thoroughly studied and several observations about the main points of the Saudi stock market were made. First, there was no organized legal framework for the proposed stock market. Instead, it was controlled independently by three government agencies: the Ministry of Finance and National Economy, the Saudi Arabian Monetary Agency (SAMA) and the Ministry of Commerce. Thus,

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[4] Saudi Arabian Monetary Agency (SAMA) is the central bank of Saudi Arabia. See the official websites <http://www.sama.gov.sa/en-US/Pages/default.aspx> accessed 28 October 2015.
[5] CMA, *Annual Report 2007* (Riyadh 2007) 16.
[6] Azzam (n3) 141–42; Aljazira Capital (n 2).
[7] Mohamed A. Ramady, *The Saudi Arabian Economy: Policies, Achievements, and Challenges* (Springer 2005) 146–47; Azzam (n3) 141–42.
[8] ibid; Y. Al-Jeffery, *Investment in the Saudi Stock Market* (Daar Al-Maanaheg Press 1993) 13–14.

there was no official policy to regulate stock market activities.[9] Secondly, there were a number of unprofessional and unlicensed brokers who had emerged to deal with shares in unhealthy operations and unproductive share ownership control. Thirdly, members of the board and/or its founding members owned a large percentage of the issued shares; they were in a position to set the market price depending on what the market would bear at any given point in time. Lastly, most Saudi citizens had little understanding of how the stock market functioned.[10] As a result, most transactions were made without reference to the financial position or statements of firms such as their stability or profitability.

In addition to these four characteristics, the few channels for investment in the nation's economy, contrasted to the excess cash available, aided speculative behaviour in the Saudi stock market during its initial stage. On the other hand, some people argued that the stock market failed to encourage more public investment in the market, although there were a few publicly owned enterprises. For example, until 1975 there were only fourteen companies listed on the stock market.[11] However, the oil boom in the late 1970s, the Saudization programme for the foreign-owned commercial banks, and the government’s privatization strategy for public companies led to an increase the number of listed companies in the Saudi stock market, to 38 in 1983.[12]

2.2.2 The Second Stage (1983–2002)

From the beginning of 1970, the eventual goal of the Saudi Arabian government was to reduce dependence on oil as the main source of national income in Saudi Arabia and to diversify the Saudi economy.[13] The first three ongoing development plans (1970–75, 1976–80, and 1981–85) focused on meeting economic objectives in the initial phase – infrastructural improvement, human resource development, and

[9] Rodney Wilson, *The Economics of the Middle East* (Macmillan 1979).
[10] Y. Al-Jeffery, *Investment in the Saudi Stock Market* (Daar Al-Maanaheg Press 1993) 13–14.
[11] ibid.
[12] Ramady (n7)146–47; Azzam (n3)141–42; Nesma Ahmed Heshmat , ‘Analysis of the Capital Asset Pricing Model in the Saudi Stock Market’ (2012) 29 (2) International Journal of Management 407, 504–05.
[13] Ahmed A. Alzahrani, Andros Gregoriou and Robert Hudson, 'Price Impact Of Block Trades In The Saudi Stock Market' (2013) 23 (1) Journal of International Financial Markets, Institutions and Money, 1, 325; Capital Market Authority, Investing in the Stock Market On 2/6/1424H (31/7/2003) <http://www.cma.org.sa/En/Documents/IA/Booklet_2.pdf> accessed 28 October 2014.

promotion of the standard of living for Saudi citizens. After 1986, the subsequent ongoing five-year development plans focused on involving the private sector in the economy and enticing foreign investment to form joint ventures with the public and private corporations.[14]

This economic strategy, designed in the first phase, moved the Saudi stock market into the second development stage – the established stage. At this stage, the Saudi government aimed to regulate and modernize the capital market to ensure safe and efficient functioning of the stock market to help accomplish its five-year development plan's goals. Although this second stage was in effect by 1985, it actually began in early 1983, with the formation of the Ministerial Committee's to govern and regulate the stock market.[15] The 1997 SAMA Annual Report credits the Ministry of Commerce with direct responsibility for primary market offerings and the regulation and supervision of joint-stock companies.[16] From 1983 to 2003, the Saudi stock market showed significant improvements in almost every aspect, such as structure, operation and regulation.[17] The 1997 SAMA Annual Report lists some of these improvements as follows:[18]

1. Intermediation services for share trading were limited to 12 commercial banks with a maximum commission of 1 per cent.
2. In 1984, the Saudi Share Registration Company (SSRC) was established jointly by these 12 commercial banks. In addition to providing central registration facilities for joint-stock companies, it settles and clears all share transactions. From 1984 to 1989, SSRC used automated system for stock market transactions.
3. In 1989, the National Centre for Financial and Economic Information (NCFEI) created a general index to measure the performance of the Saudi stock market. The NCFEI index is a capitalization-weighted index with a base value of 100

[14] Aljazira Capital (n 2) 3– 4.
[15] Kirt C. Butler and S.J. Malaikah, 'Efficiency and Inefficiency in Thinly Traded Stock Markets: Kuwait and Saudi Arabia' (1992) 16 (1) Journal of Banking and Finance 1, 199–200; Oxford Business Group, 'The Report: Saudi Arabia' (2010) 87–90; Abdulaziz M. Al-Dukheil, 'The Development of the Saudi Stock Market' (Gulf Investment Bank B.S.C 1988).
[16] Saudi Arabian Monetary Agency (SAMA) *Annual Report* (1997).
[17] Azzam (n3)173-180; Anthony Shoult, *Doing Business With Saudi Arabia* (Global Market Briefings 2006) 195-205; Joseph W. Beach, ' The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 (2) Stanford Journal of International Law 181, 310.
[18] Saudi Arabian Monetary Agency (SAMA) *Annual Report* (1997).

and the starting date was 28 February 1985. Another general index was launched in 1995, the Consulting Centre for Finance and Investment (CCFI) index, which was created by a private consulting centre in Riyadh.

4. In 1990, SAMA introduced Electronic Share Information System (ESIS). ESIS concentrates all multi-location equity trading into a single floorless market and processes buy-sell orders from order entry to ownership transfer.

5. In October 2001, the ESIS was modified and renamed the 'Tadawul All Share Index' (TASI). Unlike its predecessor, TASI facilitates a fully integrated trading, depository, clearing, and settlement system with T+0 settlements. It also handles online trading and has increased the capacity of electronic trading and incorporate instruments other than equities like corporate bonds, government bonds, and mutual funds. TASI also enables all listed companies to report their announcements and their financial statements to the public and banks.[19]

6. Participation in the Saudi stock market was gradually opened in 1997 to foreign investors, through a wide range of local mutual funds operated by the commercial banks.[20]

2.2.3 The Modern Stage (2003–Present)

The Saudi government continued to support the Saudi financial market to accomplish the goals of ongoing five-year development plans.[21] In 2003, the Capital Market Authority (CMA) was set up by the government as a separate regulatory body accountable to the capital market law legislated under Royal Decree No M/30, dated 2/6/1424H (this date in the Islamic calendar corresponds to 31 July 2003 on the Gregorian calendar).[22] The duties of the CMA are summarized below:[23]

- Improving and regulating the capital market.

[19] Saudi Stock Exchange (Tadawul), *Tadawul Annual Report* (2002).
[20] Saudi Arabian Monetary Agency SAMA, *Annual Report* (1997).
[21] Bushra Ali Gouda, 'The Saudi Securities Law: Regulation of the Tadawul, Stock Market, Issuers, and Securities Professionals Under the Saudi CML 2003 of 2003' (2012) 18 (1) Annual Survey of International and Comparative Law 1,115-118 <http://digitalcommons.law.ggu.edu/annlsurvey/vol18/iss1/8> accessed 23November 2015; John H. Donboli and Farnaz Kashefi, 'Doing Business in the Middle East: A Primer for U.S. Companies' (2005) 38 (2) Cornell International Law Journal 328, 431–34; Capital Market Authority (n1).
[22] Capital Market Authority, *Annual Report* 2007,16.
[23] Capital Market Authority, 'About Capital Market Authority' (Capital Market Authority) <http://www.cma.org.sa/En/AboutCMA/Pages/default.aspx> accessed 23November 2015.

- Enhancing protection investors and the public from illegal and unfair actions, such as fraud, dishonesty, deception and unfair trade.
- Applying best practices to guarantee fair, efficient and transparent financial transactions.
- Developing scales to mitigate the risk affiliated with financial transactions.
- Improving, regulating, and supervising the issuance of and trade in financial securities.
- Regulation and supervision of activities adopted by entities operating under the control of the CMA.
- Regulation and supervision of disclosure and information related to the financial market and entities operating under the control of the CMA.
- Regulation of market operations and public offerings.

2.2.4 The Active Capital Market

Despite operating without a formal regulation agency or a specific set of laws to govern it, Saudi Arabia has had a thriving securities market for some time. In 1996, the shares of seventy Saudi companies were being traded. Total market capitalization was SAR 172 billion (US$ 45.9 billion) with a market P/E ratio of 13.1.[24] This capitalization qualified it as the thirteenth largest emerging market, and more importantly the biggest in the Gulf region.[25] With 740 million shares available and 1.67 million individual shareholders, the Saudi capital market enjoyed relative success.[26]

Success usually breeds success, and growth in the Saudi capital market was increasing the possibility for more growth. The macro-economic climate was favourable for securities market growth. The potential supply was also high because the volume of savings in the economy was large. Meanwhile, many of the larger enterprises in Saudi Arabia had reached their limits in acquiring capital from banks (due to restraints on banks' investments), and they were too large to qualify for the government's financial support programmes. Combined with the total lack of a bond market, these factors created a largely unsatisfied demand for home-based capital.

[24] Azzam (n3)173–180.
[25] ibid.
[26] ibid 175; Shoult (n17)195–205.

During the same period, a vast pool of potential capital was awaiting the proper legal regime to free it from the banks. Savings in Saudi Arabia have always been high, but they have mostly been in the form of demand deposits in Saudi banks. Because of the usury restrictions of Islamic law, half of these demand deposits were non-interest-bearing. Internal Saudi projections showed that from 1995 to 2000, the Saudi capital market would grow by SAR 30–45 billion (US$ 8–12 billion).[27] This demand for capital could be met with a mere 20 per cent of the Saudi's non-interest-bearing demand deposits (10per cent of the total demand accounts).[28]

2.3 The Current Operational Structure

Among Saudi Arabia's greatest assets have been its operational infrastructure. At its centre, there were two organizations: the Electronic Securities Information System (ESIS) and the Saudi Share Registration Company (SSRC). As will be discussed below, these two organizations were the model of what any emerging market would like to produce after ten years of capital market development.

2.3.1 The Electronic Securities Information System (ESIS)

During 1995, Saudi Arabia had a continuous trading market, and instead of allowing securities to be traded at limited times only (a periodic market), the Saudi capital market allowed for nearly continuous posting and matching of buy-and-sell orders.[29] The only modification imposed during the opening phase of each day was a trading limit; this allowed for the orderly clearing of outstanding orders prior to the full opening of the market. The Saudi capital market was also an order-driven market. As such, the dealers were limited to enter and match buying and selling orders. Due to the conscious policy of decision-making by the Saudi government, there were no specialists or market makers in the Saudi capital market. Further, the Saudi capital market was entirely electronic and had no trading floor.[30]

[27] Ramady (n7)151.
[28] Beach (n17)309–11.
[29] Anthony H Cordesman, *Saudi Arabia Enters The Twenty-First Century* (Praeger 2003) 439; Rolf Meyer-Reumann, 'The Banking System In Saudi Arabia' (1995) 10 Arab Law Quarterly, 228-229.
[30] Niḍāl Rashīd Ṣabrī, *Financial Markets and Institutions in The Arab Economy* (Nova Science Publishers 2008), 113; Anthony H Cordesman, *Saudi Arabia Enters The Twenty-First Century* (Praeger 2003) 439-450; Beach (n17)309–11; Abdulaziz M. Al-Dukheil, ' Saudi Stock Market'

The computerized centre of the Saudi capital market was ESIS a widely distributed computer network trading system linking the banks of Saudi Arabia via the existing telecommunications infrastructure of the country. In 1990, Electronic Securities Information System (ESISLINE) began delivering market price and volume information to member banks. Five years later, there were over 400 outlet locations of ESISLINE. SAMA unveiled ESISNET, the actual trading network linked to a central computer trading system in 1992. By 1995, over 250 banks were linked to this system, allowing them to input trading orders, track trade execution and print trade confirmations. Orders entered at remote locations were and transmitted to the Central Trading Unit, where they were matched against other buy or sell orders. The central market surveillance unit at SAMA's oversaw the matching process. After SAMA's surveillance unit matched the orders, confirmation was instantly available at the remote locations. SAMA owned and operated ESIS and recouped the operating costs through indirect fees charged to all Saudi banks regardless of their participation in the network.[31]

2.4 The position of Islamic Law in Saudi Arabia

The Saudi Arabia has always sought to establish justice. Its constitution is the Holy Book of ALLAH and the guidance of the messenger (peace be upon him). This started by with announcement made by the King Abdul-Aziz on 12/05/1343 (Islamic calendar) where he stated that: 'resolving issues in the holy land is by consultation [negotiation] between Muslims and the main source of law must not be other than from the Holy Book, Prophet's guidance and scholars' jurisprudence.'[32]

(Conference on The Future Vision for the Saudi Economy, Ministry of Planning, Kingdom of Saudi Arabia, October 2002) <https://uqu.edu.sa/files2/tiny_mce/plugins/filemanager/files/4150111/fourm/REVISED-SAUDI%20STOCK%20MARKET-05-10-2002-KM.pdf> accessed 23November 2015.

[31] Beach (n17)309–11; Mohammad Al-Jarf, 'eBanking in Saudi Arabia: Trends and Perspectives' (Umm al-Qura University, Makkah, Saudi Arabia). <https://domino.fov.unimb.si/ECBledHome.nsf/5f5370162bfefab8c12565ef00600a0c/4601db664b51831dc1256d4e002be877?OpenDocument> accessed 24November 2015.

[32] Mohammed Alsaidi, *Qraah Shariyah Fi Alnyzam Alsaudi* <http://www.m-aqdah.com/vb/showthread.php?t=1203> accessed 24November 2015.

In another notification in year 1344 (Islamic calendar) he said: ‘Islamic Law must have the first place as source of law.’ [33]

2.4.1 Nature of legislative system

It came as primary law and stated that the Holy Book (Qur’an) and the teachings of the Prophet (Sunnah) form the constitution of Saudi Arabia. The first article of this primary law states that:

> Saudi Arabia is a fully sovereign Arab Islamic State. Its religion shall be Islam and its constitution shall be the Book of God and the Sunnah [Traditions] of His Messenger, may God’s blessings and (peace be upon him). Its language shall be Arabic and its capital shall be the city of Riyadh.[34]

This article has been enforced by others for better clarification. In article 4:

> the ruling system in the Saudi Arabia draws its power of the book of ALLAH and the teachings of the Prophet, they are the main rulers dominating all systems of the country.[35]

Paragraph b of the article 5 states that:

> Governance shall be limited to the sons of the Founder King ‘Abd al-’Aziz ibn ‘Abd ar-Rahman al-Faysal Al Sa’ud, and the sons of his sons. Allegiance shall be pledged to the most suitable amongst them to reign on the basis of the Book of God Most High and the Sunnah of His Messenger (peace be upon him).[36]

The ‘ruling system’ in article 4 refers to the practical side of the first article, which describes the Holy Book and the teachings of the Prophet as the constitutions of the nation, where the allegiance is similar to ‘constitutional sworn’ known in the nations, where the king or president has to swore in front official representatives which would contain saving or respecting the constitution.

Article 7 does not only confirms that the Qur’an and the Sunnah as the main references points of the country’s constitution , but states quite clearly and explicitly

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[33] Speech by King Abdul-Aziz <http://www.m-aqdah.com/vb/showthread.php?t=1203> accessed 24 November 2015.
[34] Basic Law of Governance 1992, art1.
[35] ibid art4.
[36] ibid art5(b).

that the Qur'an and the Sunnah are the sources of power in Saudi Arabia, and states their power of governance on the regime and all systems of the country:

Governance in Saudi Arabia derives its authority from the Book of God Most High and the Sunnah of his Messenger, both of which govern this Law and all the laws of the State.[37]

Article 8 states that:

> Governance in Saudi Arabia shall be based on justice, shura [consultation], and equality in accordance with the Islamic Shariah.[38]

Article 55 deals with the duties of the king:

> The King shall run the affairs of the nation in accordance with the dictates of Islam. He shall supervise the implementation of Islamic Law and the general policies of the State, and the protection and defense of the country.[39]

2.5 The Legal Structure of Judicial system in Saudi Arabia; and its subsequent development.

Most of Saudi Arabia's basic contract and commercial laws were *Fiqh Al Muamalaat* – the commercial aspect of Islamic law.[40] This law was not specifically codified, and the commercial statutes of that time were incomplete. In this term, the Saudi government refers to the Hanbali School. However, in the Ottoman codified law of the ninteenth century, *Majallah al-akhkam al-'adiliyya*, we can find five rules that directly contradicted the canonical texts, but were nonetheless supported by jurists on the basis of reducing hardship by altering customary practices.[41] Some have even gone so far to say that customary practices are similar to canonical rulings. In article 39 of the Ottoman codification, it was stated that juristic rulings must keep up with the times.

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[37] ibid art7.
[38] ibid art8.
[39] ibid art55.
[40] Frank E Vogel, *Islamic Law and Legal System* (Brill 2000).
[41] Ali Hydar, Durar al-ahkam Sharh Majallah al-ahkam, Arabic Edition (Dar Alam Alkutab 2003); Mohammed Ali, *Majallah al-ahkam al-'adiliyya'* (Almaoswaah 2011).
< http://www.alghoraba.com/mawsoaa/majala%20alahkam.htm> accessed 24November 2015.

Traditionally, Islamic jurisprudence is divided into eight periods. The first period ended with the death of the Prophet Muhammad in 632 CE, while in the second period, which lasted until 670 CE, the companions of the Prophet interpreted the Islamic rulings or directions from the Qur'an and the Sunnah.[42] The third period gave rise to two camps of jurists: *Ahl Rai* (people of opinion) and *Ahl al Hadith* (people of tradition). This was the golden age of classical Islamic jurisprudence, lasting from the beginning of the second century to the middle of the fourth century AH. From the mid-fourth century, jurists limited themselves to deriving laws within the framework of their own juristic schools. This lasted until the middle of the seventh century AH. The fall of Baghdad to the Tartars in 1300 CE marked the beginning of the dark age of Islamic jurisprudence. The Ottomans' codification of Hanafi *Fiqh* in the form of the *Majallah* in 1876 CE, marked the renaissance of Islamic jurisprudence. From the late nineteenth century onwards, revivalist and reformist movements began, led by figures such as Muhammad Abdu and Jamal Uddin al Afghani, whose aims were to reinterpret classical rulings for modern times. Finally, in the most recent period, Islamist trends predicated goals of establishing Islamic states and Islamic economics. As a result of the Islamist movement, classical jurisprudence is read uncritically and this has given rise to inefficiency in Islamic financial industries.[43]

2.5.1 Judicial Bodies in Saudi Arabia

The judicial and semi-judicial bodies currently operating in Saudi Arabia do so under different ministries, depending on the subject matter of disputes. For example, semi-judicial committees like the Committee for the Settlement of Customs Disputes operates under the Ministry of Finance, whilst the courts operate under the Ministry of Justice.

2.5.1.1 The Ministry of Justice

The Ministry of Justice was set up following an order from King Faisal in 1962, and the first judiciary law was issued in 1975. Until 2007, the Ministry of Justice was

[42] Maren Hanson, 'The Influence of French Law on the Legal Development of Saudi Arabia' (1987) 3 Arab Law Quarterly 205, 272-274.
[43] ibid.

organized in such a way that there was no specialization of the courts, and a judge might have ruled on a variety of different issues in the same day. However, Baamir notes that following an amendment in 2007[44] and a subsequent transition period, this non-specialization of the courts has changed along with several other elements of the judicial system, including the role of the ministry, the jurisdiction of different types of courts and the appointment of judges.[45]

2.5.2 The Current Judicial and Court System

Currently, Saudi Arabia has two judicial systems that comprise of several statutory tribunals and Shariah courts.[46] Nonetheless, the most significant of those tribunals is the Diwan al Mazalim, sometimes referred to as the Board of Grievances, that is, the Shari'ah courts.[47]

2.5.2.1 The Supreme Judicial Council

The Supreme Judicial Council (SJC) is the supreme judicial authority in the country.[48] It performs various legislative, judicial, administrative and consultative functions. With respect to its judicial responsibilities, the SJC evaluates and reviews court cases, especially those that involve the death penalty as well as serious crimes.[49] The SJC is made up of eleven members and is presided over by a senior member of the judiciary or the chief of the SJC.[50]

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44 2007 Law of Judiciary.

45 Abdulrahman Baamir and Ilias Bantekas, 'Saudi Law as Lex Arbitri: Evaluation of Saudi Arbitration Law and Judicial Practice' (2009) 25(2) Arbitration International 244.

46 Abdullah F Ansary, 'A Brief Overview of the Saudi Arabian Legal System' (New York University 2008) <http://www. nyulawglobal. org/globalex/Saudi_Arabia. Html> accessed 24 December 2014

47 Royal Decree No. 02/13/8759 of 1374 H (1955); Baamir and Bantekas (n45).

48 Judiciary Act 1975, art5.

49 International Business Publications, *Saudi Arabia Company Laws and Regulations Handbook* (International Business 2008) 74.

50 According to Al- Ansary: "The Supreme Judicial Council is composed of eleven members. Five full-time members hold the rank of Chief of the Appellate Court and constitute the Permanent Panel of the Council.Five part-time members include the Chief of the Appellate Court or his deputy, the Deputy Minister of Justice, and the three members with the longest time in service as Chief Judges of the General Courts in the following cities: Makkah, Medina, Riyadh, Jeddah, Dammam and Jazan. All members constitute the General Panel of the Council, which is overseen by its Chairman." Ansary (n 47); See also: Joseph A Kechichian, *Legal and Political Reforms in Sa'udi Arabia* (Routledge 2013) 30–31.

Under the amended system, the duties of what was previously known as the Supreme Judicial Council have been split between the High Council, which is now in charge of appointing judges and supervising judicial affairs, and the High Court, which is the highest court in Saudi Arabia. The High Court is the final Court of Appeal and all decisions will be binding upon all other courts.[51]

2.5.2.2 The Courts of Appeal (Courts of Cassation)

The Courts of Cassation or Appeal comprise of a number of panels that have powers to prosecute personal and private matters, crime and other relevant matters.[52] Currently, Saudi Arabia has two Courts of Appeal.[53] These are located in two different geographical regions to promote access to judicial services. The Mecca Court of Appeal, has jurisdiction to hear appeals originating from lower courts of the western provinces of Saudi Arabia,[54] while the Riyadh Court of Appeal, has jurisdiction to hear appeals from lower courts from the eastern and central provinces.[55] Unlike in other countries, the two Courts of Appeal never reverse the decisions made in the lower courts. However, the Courts of Appeal often remand the case back to the trial courts or affirm the decisions made by the judges in the lower courts. In the event that a judge in the lower court maintains the decision by the first-instance, the Court of Appeal may overrule that decision by appointing another panel or judge to hear the case.[56]

2.5.2.3 First-Instance courts (General and Summary Courts)

The first-instance courts in Saudi Arabia are made up of the general courts and the summary courts. The general courts have jurisdiction to hear and give rulings on

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[51] Ayoub M. Al-Jarbou, 'The Role of Traditionalists and Modernists on The Development of The Saudi Legal System' (2007) 21 (3) Arab Law Quarterly 189, 202-203.
[52] USA International Business, *Saudi Arabia Company Laws and Regulations Handbook* (Intl Business 2015) 50–53.
[53] Under the Judiciary Act 2007, art 15, one or more appeal courts will be established in each province in Saudi Arabia.
[54] Shahid M Shahidullah, *Comparative Criminal Justice Systems: Global and Local Perspectives* (Jones and Bartlett Learning 2012) 406.
[55] Harry R Dammer and Jay S Albanese, *Comparative Criminal Justice Systems* (Cengage Learning 2013) 400.
[56] Ansary (n 47).

cases involving death penalties, civil cases and serious criminal offences.[57] Summary courts have the power to preside over cases that are pertaining to *Hadd* crimes (crimes involving fixed punishment, set out in the Qur'an). Summary courts also hear cases involving *Tazir* crimes (cases set out in statute, which are often minor in scope), compensation cases and cases involving monetary crimes. General courts and summary courts often have one judge for every court, but there can be instances where there are more than six judges in one court.[58]

2.5.2.4 The Board of Grievances

The Board of Grievances was initially intended to have jurisdiction over cases pertaining to the Royal government.[59] Traditionally, the Board of Grievances settled cases that involved government contracts as well as administrative disputes. The Board of Grievances was granted some formal judicial powers in 1982 following the publishing of Royal Decree No M/51.[60] Apparently, the Board of Grievances was set up to be directly responsible to the Saudi Arabian King. Besides other legal issues, the decrees gave authority to the Board of Grievances to enforce the rulings of foreign courts, to hear some government-related cases and also cases involving criminal offences. Consequently, the decree granted the Board of Grievances jurisdiction over cases involving commercial interests. The Board of Grievances has its headquarters in Riyadh but it also has offices in Abha, Jeddah and Dammam. The Board's hierarchical structure is made up of several circuits that are in turn made up of first-instance circuits, appeal circuits and the Board of Appeal circuits.[61]

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[57] Robert W Jordan, Natasha Zahid and Baker Botts, 'Saudi Arabia: Litigation Guide' (IBA Guide: Litigation Committee, 2009) <http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=9&cad=rja&uact=8&ved=0CFUQFjAI&url=http%3A%2F%2Fwww.ibanet.org%2FDocument%2FDefault.aspx%3FDocumentUid%3DBCE071B8-64D5-43D8-A047-7FE45BAB7E8C&ei=aZKbVMaHO4viywP_qICgCw&usg=AFQjCNFCs9n3lF_8hBVUUhMwW6pvveVKDQ&sig2=Mk2QVJNi7QyI6DT71RXTeg> accessed 26 November 2015.
[58] USA International Business (n 52).
[59] USA International Business (n 52).
[60] Ansary (n 47).
[61] ibid; USA International Business (n 52).

2.5.2.5 Quasi- Judicial Commission and Administrative Committees

There are many quasi-judicial commissions that have judicial roles completely independent of either the general judiciary or the administrative branch. Among these are those that adjudicate in relation to banking disputes, issues concerning bank notes, insurance claims, and also customs disputes.[62]

These commissions have two levels of litigation: primary and appeal, with some acting in both the former and latter capacity, for example, in cases involving disputes in relation to bank notes; other commissions are restricted solely to primary litigation. The formation of the commissions and their latitude with respect to appeals vary from commission to commission. The commission dealing with disputes in relation to bank notes, for example, was formed by the Financial Market Authority, whereas its own appeals department was established by order of the Council of Ministers and its board members are drawn from and represent three different government agencies. The commission dealing with banking disputes was itself created by royal decree. These commissions have been charged by the King with overseeing a range of financial issues and concerns, principally as a result of the absence of specialist financial knowledge among Sariah scholars within the Saudi Arabia.

2.5.2.6 Characteristics of judicial commissions:

All judicial commissions have common attributes:

- They are answerable to government agencies
- Formation: these commissions draw on technical, legal and administrative specialists from within the judiciary

2.5.2.7 Types of Judicial commissions:

[62] Mohammed Alsahli, 'Taadud Jihat Altanazu' *Al-Riyadh Newspaper* (Al-Riyadh, 22 April 2011) Issue 15642.

There are quasi-judicial commissions with links to more than 20 different government agencies; their decisions can be argued in front of “the board of grievances”.

Judicial commissions: these deal mainly with disputes and any decisions they make are final and subject to must be executed” orders. In addition, any disputes relating to their domain can’t be raised within other agencies including the courts.

2.6 Principles of crime and punishment in the system

All Muslims consider that the Islamic law is the highest reference of all systems and authorities, and in its light all legislation and laws are issued, and all rules follow. This has been made clear in the basic ruling system, where it is said that all issued rules such as criminal rules, including those issued by courts, must be in accordance with Islamic Law.

Article 48 of the Basic Law states:

> The courts shall apply to cases before them the provisions of Islamic Law, as indicated by the Qur’an and the Sunnah, and whatever laws not in conflict with the Qur’an and the Sunnah which the authorities may promulgate.[63]

By article 67 of the Basic Law is:

> The regulatory authority shall have the jurisdiction of formulating laws and rules conducive to the realization of the well-being or warding off harm to State affairs in accordance with the principles of the Islamic Law. It shall exercise its jurisdiction in accordance with this Law, and Laws of the Council of Ministers and the Shura Council.[64]

The constitutional text is clear in making Islamic Law the source of all laws and regulations, particularly with regard to criminal issues. Article 1 of the Criminal Procedure Law states:

[63] Basic Law of Governance 1992, art48.
[64] ibid art67.

> In cases presented before them, courts must use Islamic law according to evidences from the Qur'an and the Sunnah and any orders made by the kings as long as it does not contradict the Qur'an or the Sunnah.[65]

Article 3 of the Criminal Procedure Law states:

> Punishment should not be applied except on forbidden issues, issues punishable by Islamic law, after being sure of the guilt based on a final decision made a court in accordance with Islamic law.[66]

2.6.1 Examples of crimes regarding which legislation has been issued and used in courts

Royal decree number (M/36) dated on 29/12/1412 (Islamic calendar) was issued to fight bribery in Saudi Arabia.[67] The decree indicates clearly the status of Islamic Law in Saudi Arabia. It can neither be ignored, nor replaced by any other law; even the social structure of the nation is Islamic, and will support no other system than the Qur'an and the Sunnah; however, this does not mean that advantage should not be taken of other legal systems, to better mend society, as long as these systems are not contradictory to the principles of Islamic law.[68]

2.6.2 New procedure under the criminal law of capital market authority

With respect to Royal Order No. 4690, dated 6/2/1435H, dealing with the transfer of the jurisdictions of entities and committees relating to the investigation and prosecution of criminal offences to the Bureau of Investigation and Public Prosecution. The CMA and the Bureau of Investigation and Public Prosecution agreed to transfer investigatory and prosecutorial powers in respect of violations of Articles (31), (49) and (50) of the CML from the CMA to the Bureau of Investigation and Public Prosecution as of 26/1/1436H.[69] An agreement had been reached with the Committee of Investigation and Public Prosecutions to transfer preliminary investigations in relation to violations of Articles 31, 49, and 50 of the

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[65] The Law of Criminal Procedure in Saudi Arabia 2013,art1.
[66] ibid art3.
[67] By Royal Decree No. M /36 dated 29/12/1412.
[68] The Kingdom of Saudi Arabia, *Mutual Evaluation Report of the Kingdom of Saudi Arabi*, (2010 FATF/OECD) 18–19.
[69] By Royal decree No. 4690 of 6/2/1435 H; See also Capital Market Authority, *Annual Report* 2014 (Capital Market Authority 2014) 41.

stock market regulatory code to the committee of investigation and public prosecutions.[70] In addition, the Capital Market Authority established links between systems at the Investigation Department and those at the Bureau of Investigation and Public Prosecution.[71]

The Capital Market Authority has also agreed to transfer all criminal investigations and prosecutions to the Committee of Investigation and Public Prosecutions, where these relate to violations of Articles 31, 49, and 50 of the stock market regulatory code.[72] It could be argued that this transfer represents the start of a new era for investors in the Saudi stock market. This latest move conforms to global standards and is in keeping with American stock market regulations. It establishes a harmonious legal relationship between all parties and separates the control committee, which is the financial market committee and the investigation authority which has been passed to the committee of investigation and public prosecutions. The commission charged with investigating disputes in the financial markets will, however, continue to carry on its duties; the only difference is the respondent representing the prosecution will be the Committee of Investigation and Public Prosecutions, not an employee from the stock market committee, who had previously identified regulation violations.

The first case conducted under the auspices of the new regulations when the Capital Market pursuant to the High Order No. (4690) and dated 6/2/1435H and based on the Capital Market Law and its implementing regulations- a suspicion of a violation was referred to the Bureau of Investigation and Public Prosecution as it fell under its jurisdiction.[73]

2.7 Market Manipulation

Market manipulation or stock price manipulation is the act by an individual or a group of individuals to influence a stock price to behave in such a manner as it

[70] CML, arts31, 49 and 51.
[71] Capital Market Authority, *Annual Report* 2014 (Capital Market Authority 2014) 41.
[72] CML, arts 31, 49 and 51.
[73] Capital Market Authority, Announcements, CMA announces the referral of a suspicion of violating Article (49) of the Capital Market Law and Article (2) of the Market Conduct Regulations to the Bureau of Investigation and Public Prosecution 2015 <http://www.cma.org.sa/en/News/Pages/CMA_N_1590.aspx> accessed on 22 November 2015.

would not if left to the natural forces of supply and demand.[74] It is also defined as the intentional conduct of an individual or group with the intention of deceiving investors by regulating or artificially affecting the market for that security.[75] Market manipulation with the aim of affecting stock market price is done in a variety of manners, the most prominent of which are 'manipulation' by: (i) provision of false information, (ii) stock transactions/orders, and (iii) practice/action leading to a false impression.[76]

2.7.1 Market manipulation by provision of false information

The stock exchange is an open secondary market, where shares and equities are freely bought and sold. The majority of the traders on the stock exchange lack detailed in-depth understanding of the operations and prospects of the companies whose shares they deal in. Thus trade activity on the exchange is heavily influenced by rumours and information, which can be inaccurate.[77]

2.7.2 Market manipulation by misleading transactions

As mentioned, most investors and traders have limited knowledge of the companies whose shares they trade in, and they closely follow the trend or pattern of movement in the stock exchange. The prices of shares follow their active demand and supply in the market. Certain traders can manipulate the price of shares by creating an artificial appearance of trading activity on them. Stock prices via transactions can be manipulated in a number of ways, traders start selling a particular stock quickly and in concentration during a short duration, which results in other shareholders selling the shares as well, which the manipulators then buy at lower prices (since the sudden abundance of supply results in a decrease of price). This strategy is colloquially referred to as a 'bear raid'.[78] Similarly certain traders start buying certain stocks within a short period, giving an impression of increased demand and driving both demand and prices up, from which the manipulators benefit by selling their own

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[74] Jerry W Markham, *Law Enforcement and the History of Financial Market Manipulation* (Routledge 2014) 54.
[75] As defined by the US Securities and Exchange Commission.
[76] The Law of Capital Market Law (CML), art 49, issued by Royal Decree No (M/30) dated 2/6/1424H (July 31, 2003).
[77] Emilios Avgouleas, *The Mechanics and Regulation of Market Abuse* (Oxford University Press 2005) 119–127.
[78] Alan Palmiter, *Securities Regulation: Examples and Explanations* (Aspen 2008) 313.

shares (bought when prices were low) at the inflated market price; this is colloquially referred to as a ‘bull raid’.[79] When a particular stock starts to be actively traded, usually its market value increases. Using such strategies, certain traders aim to artificially create an appearance of active trading in a particular stock, and then benefiting from the higher price. A few traders use variations of the above methods, as well as other tactics, in order to manipulate the market and profit from it.[80]

2.7.3 Market manipulation by practices/actions which lead to a false impression

In addition to misleading other people with transactions, the stock market can also be misled by actions or practices. An example of this could be a trader flooding the market with a rumour that a cell-phone company has developed a revolutionary technology, which would allow phones to generate holograms. Regardless of whether or not the rumour is accurate if people believe the rumour, to be true, they will start buying this cell-phone company’s shares in anticipation that the price will go up. This will lead to a price hike, and any trader who had bought shares earlier at lower prices, can now sell them at the inflated price, thus making a handsome profit. Similarly people can make false statements about how profitable their involvement would make a certain company, with the aim of misleading the public about its profitability. This in turn would drive up stock prices; shareholders who decide to sell, capitalizing on the price boom, would be selling their shares at prices higher than they bought them for, hence profiting from the false statement.[81]

2.8 Importance of the Stock Exchange

The stock exchange is the forum of company ownership exchange. Stock markets are essential to the progress of a country, as they are a means of generating funds and capital from investors to inject into the economy of a county.[82] A healthy stock market depicts a healthy economy; however there exists a knowledge gap between the actual future of a company and its price in stock; this gap is filled by speculation. All the shareholders and stakeholders operating in the stock exchange are dependent

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[79] ibid.
[80] Avgouleas (n77) 127.
[81] Avgouleas (n77) 147.
[82] Geoffrey Poitras, *Handbook of Research on Stock Market Globalization* (Edward Elgar 2012) 166–168.

on fair operation of the exchange and stock trading for their livelihood. If investors were not protected, this would stunt the development of the financial market. As stock exchanges grow, amateur traders enter the market, investing their savings aiming to secure profits to meet their expenses, these amateur traders are exceptionally vulnerable to market manipulation.[83]

With such high stakes, if a few traders benefit exorbitantly at the expense of others, this leads to a poor investment climate. Where people avoid investing in the stock exchange, which leads to less investment and less capital, a vicious cycle may start, causing less growth, smaller profits, smaller salaries, lesser buying power and hence ultimately a weaker economy.

2.8.1 The Saudi Stock Market and its Regulation

The Saudi stock market came into existence in the 1970s; however, since it was initially unregulated, the volume of trading remained low throughout the 1980s, until oil prices started rising.[84] This led to increased activity in the Saudi stock market. In 1985 the Saudi Government put the Saudi Arabian Monetary Agency (SAMA) in charge of the Saudi stock market. Subsequently in 2003 the Capital Market Law was promulgated under Royal Decree No (M/30) dated 2/6/1424 H (16 June 2003), which officially created/established the Capital Market Authority (CMA), a government body to protect investors and illegal acts in the stock market.[85] Pursuant to article 49 (b) of the Capital Market Law, which states that the CMA would set out rules to further elaborate and clarify upon the offences listed in the Capital Market Law,[86] the CMA set out the Market Conduct Regulations(MCR).[87] Cognizant of the hazards of market manipulation to the stock market, and hence the entire economy,

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[83] Avgouleas (n77); Viktoria Dalko and Michael Wang, *Regulating Competition In Stock Markets* (Wiley 2012).
[84] Doing Business and Investing in Saudi Arabia Guide, Vol 1 Strategic and Practical Information (International Business Publication 2015) 155; Ramady (n7)146-147.
[85] Ramady (n7)148–149.
[86] CML art 49(b).
[87] Amr Daoud Marar, 'The Duality of The Saudi Legal System and Its Implications on Securitisations' (2006) 20 Arab law Quarterly 333, 389–390

the Saudi Authorities have proscribed it through article 49 of the Capital Market Law and articles 2 and 3 of the MCR.[88]

The Capital Market Law and the MCR are meant to be read and applied in conjunction.[89] In application, article 49 of the Capital Market Law and articles 2 and 3 of the MCR, contain a 'material' as well as a 'moral' elements.[90] The 'material' element is physical, such as conducting a series of transactions, which would create a false impression of active trading, and inflate the stock price. The 'moral' element is mental, and is satisfied when the person conducting the act is aware of its nature and had the intention of conducting the act that implies manipulation or fraud. An example of the 'moral' element would be an individual who intentionally conducted some of the transactions described above, with the knowledge that his actions would lead to an artificial alteration of price. This may be seen as comparable to the intent requirement that is an element of the criminal offences dealing with market abuse in the UK.[91]

2.8.2 Insider Trading

Insider trading is classically defined as the use of material, non-public information by a trader, corporate insider or somebody who owes the company a fiduciary duty.[92] The United States Securities and Exchange Commission makes a distinction between legal and illegal insider trading, the former being when 'corporate insiders'[93] buy and sell stock in their own companies, and the latter the buying or selling of a security, in breach of a fiduciary duty while in possession of material, non-public information about the particular stock.[94] Insider trading, like market manipulation, removes traders' confidence in the market, hence less investment enters the market, which leads to a downward spiral of less capital, less growth, less production, less

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[88] CML art 49; MCR arts 2 and 3.
[89] Ramady (n7)149–150.
[90] As mentioned in Case No 38/31 CRSD Decision No 798/L/D1/2010 of 1431 H; Case No 11/30 CRSD Decision No 664/L/D1/2009 of 1431 H; Case No 63/30 CRSD Decision No 663/L/D1/2009 of 1430 H; Case No 91/30 CRSD Decision No 665/L/D1/2009 of 1431 H.
[91] Gouda (n 21)152–154; Beach (n 17)342–343.
[92] *Black's Law Dictionary* (9th edn, West 2009) 866.
[93] 'Corporate insiders' are a company's officers and directors, and any beneficial owners of more than 10 per cent of a class of the company's equity securities registered under s 12 of the US Securities Exchange Act of 1934.
[94] US Securities and Exchange Commission, 'Insider Trading' (*SEC*) <http://www.sec.gov/answers/insider.htm> accessed 26 November 2015.

profits, etc, which adversely affects the entire economy. The minimization of insider trading requires 'both good corporate control and effective enforcement of insider trading regulations'.[95]

The Saudi Authorities, realizing the importance of protecting the market and other stake holders have proscribed insider trading under article 50 of the Capital Market Law, which is further elaborated upon by articles 4–6 of the MCR.[96] Article 50 of the Capital Market Law prohibits any individual who is aware of or comes into possession of such information, which is not publicly known (or disclosed) and the release of which would have a material effect on share prices. Articles 4–6 of the MCR (set out under article 50(c)) further elaborate and clarify upon article 50 of the Capital Market Law; they also expressly make the disclosure of insider information (article 5 of the MCR), and acting upon knowledge of the same, offences (article 6 of the MCR).[97]

It is pertinent to mention here that Saudi Arabia is having just an only legislation and that is Capital Market Law 2003 and it does not talk about any effective solution of market manipulation.[98] In 2003, the Capital Market Authority (CMA) was established by the government as a separate regulatory body accountable to the capital market law legislated. The Financial Commission within the Consultative Council criticised the extended powers of the Financial Market Committee, which had arrogated to itself the right to impose penalties in favour of the Committee without consulting the Commission dealing with bank notes disputes.[99]

The Commission argues that this runs counter to the spirit of the regulations and gives the violator the opportunity to pay a penalty without being subject to investigation, publicity or payment of penalties as prescribed by law. And so the Financial Commission within the Consultative Council requested in a behest letter

[95] Financial Institutions and Markets, *Current Issues in Financial Markets* (Palgrave Macmillan 2008) 203.
[96] CML art50; MCR arts 4–6.
[97] Gouda (n 21)154; Beach (n 17) 344.
[98] See 2.2.3.
[99] *Al-Riyadh Newspaper* (Al-Riyadh, 5 November 2012).

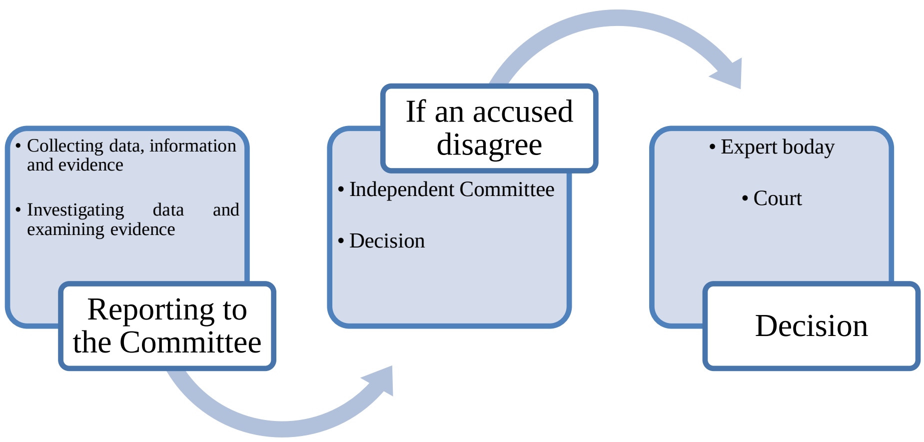
that the Consultative Council discuss the matter and refer violators to the Commission dealing with disputes.[100]

In order to addressing this obstacle facing the capital market authority should the Saudi government establish independent committee. This committee should have an independent entity and not accountable to capital market authority anyway. It is to counter the market manipulations, effectively and if anyone found guilty the committee can take the cognizance of the case, and punish the accused without taking further permission from capital market authorities.

However, if an accused disagree with the decision, an option he may be able to invoke the cognizance of the court. In this regard the courts should have the excess to the experts relating to market manipulations, in-order to get the advisory opinion and further recommendations. There should be a body wise enough and knowledgeable like a *Muslim Judicial Council* to seek advice and if required get recommendations on the issues related to the market manipulations time to time.

Like a British Judicial system, it is recommended that the Judges should be well aware, well acquaint and well informed with the latest knowledge relating to the financial market and its manipulations. (See diagram 2).

Diagram 2: The recommended process of investigation into violation



[100] ibid.

2.9 Select Decisions of the Committee for Resolution of Security Disputes[101]

Case No 29/26 Decision No 9/L/D1/2006 of 1426 H

Case Facts:

The accused had been trading in the shares of company X; while trading, he entered a series of sale orders in a successive manner with a declining sequence of rates, which were not implemented; additionally he placed both sale and purchase orders for the same stock. The accused was indicted by the CMA for conducting trade of the shares of company X in such a manner as to create a false and misleading appearance of activity and increasing the price of the share so that others were urged to buy and sell them.

As I mentioned in the legal structure of judicial system in Saudi Arabia, the most of basic contract and commercial laws were *Fiqh Al Muamalaat* – the commercial aspect of Islamic law.[102] This law was not specifically codified, and the commercial statutes of that time were incomplete. In this term, the Saudi government refers to the Hanbali School.[103] Subsequently in 2003 the Capital Market Law was promulgated under Royal Decree No (M/30) dated 2/6/1424 H (16 June 2003), which officially created/established the Capital Market Authority (CMA), a government body to protect investors and illegal acts in the stock market.[104] Pursuant to article 49 (b) of the Capital Market Law, which states that the CMA would set out rules to further elaborate and clarify upon the offences listed in the Capital Market Law,[105] the CMA set out the Market Conduct Regulations(MCR).[106] Cognizant of the hazards of market manipulation to the stock market, and hence the entire economy, the Saudi Authorities have proscribed it through article 49 of the Capital Market Law and

[101] I believe that the endeavour regarding the issue in this section is adequate and limited to the Market Manipulation Law 2003 in Saudi Arabia, and also well addressed. However, the Author has mentioned very clearly the origin and Philosophy of the particular law in chapter 3 and 4. Hence the author further believes that mentioning the said notes again will be ending in repeating the same.
[102] Frank E Vogel, *Islamic Law and Legal System* (Brill 2000).
[103] See (chapter 2, 2.4.1 Nature of legislative system)
[104] Ramady (n7)148–149.
[105] CML art 49(b).
[106] Amr Daoud Marar, 'The Duality of The Saudi Legal System and Its Implications on Securitisations' (2006) 20 Arab law Quarterly 333, 389–390

articles 2 and 3 of the MCR.[107] Under the capital market law 2003 all cases must go through the Committee for the Resolution of Securities Disputes (SRCD).

Application of Law:

The CMA indicted the accused for violating article 49 of Capital Market Law and article 2 of the Market Conduct Regulations, as he entered a series of sale orders in a successive way with a pattern of reducing rates and without the intention to execute.[108]

(i) Entering a series of sale orders in a successive way with a pattern of reducing rates

Entering a series of sale orders in a successive way, with a pattern of reducing rates has the effect of introducing excess stock in the market, which lowers the price of stock. This has a domino effect, as other stock holders following the market trend also start to sell the stock they own, which in turn further reduces the price of the said stock. The manipulator/accused can now start buying the stock at an artificially reduced rate. Article 49(a) of the Capital Market Law makes it an offence to intentionally engage in any action which creates a false or misleading impression of the price of any stock, inducing third parties to buy or sell it.[109] Article 49(c) lists the types of acts that are considered 'manipulation' under article 49(a).[110] It lists one of these practices as being to affect the price of a security by 'causing an increase or decrease in the prices of such Securities, for the purpose of inducing third parties to buy or sell such Securities'.[111] Thus article 49(a), as elaborated upon by article 49(c), makes the accused's action an offence, as the accused entered a series of sale orders in a successive pattern of reducing rates, in order to reduce stock price and induce third parties to sell their shares. [112]

[107] CML art 49; MCR arts 2 and 3.
[108] CML art49; MCR art2.
[109] CML, art49(a).
[110] CML, arts49(a) and (c).
[111] CML, art49(c).
[112] CML, arts49(a) and (c).

The MCR formed under article 49(b) of the Capital Market Law further elaborates upon the practices that constitute violations of article 49(a).[113] Article 2(a) of the MCR prohibits the engaging or participation in any manipulative act in relation to the transaction of securities, and article 2(b)(2) prohibits the creation of an artificial trade price.[114] Article 3(b) of the MCR list the acts and practices that would constitute practices that would be considered manipulative or deceptive for the purpose of creating a false or misleading impression.[115] The accused placed successive sale orders at reducing rates and thus his acts fell under article 3(b)(4) of the MCR, which makes the selling or making offers to sell of securities a manipulative or deceptive practice, as required by article 2 of the MCR.[116]

The accused actions of entering a series of sale orders in a successive way, with a pattern of reducing rates, are in breach of article 49(a) of the Capital Market Law, read along with articles 2(a) and 2 (b)(2) of the MCR.[117]

(ii) Entering a series of sale orders without the intention to execute:

In addition to the above, article 3(b) (5) point 4 of the MCR makes the entering into security sale orders that are not intended to be executed a manipulative or deceptive act in itself, committed for the purpose of creating an artificial trade price.[118]

Case No 38/31 CRSD Decision No 798/L/D1/2010 of 1431 H

Case Facts:

The accused was in the business of trading in the securities of a number of banks and companies. While trading on these securities the accused placed multiple purchase orders, some of which were implemented partially, fewer still completely, and mostly were cancelled without being implemented.

[113] CML, arts49(a) and (b).
[114] MCR, arts2(a) and (b); MCR, art2(b)2.
[115] MCR, art3(b).
[116] MCR, arts2 and 3(b)4.
[117] CML, art49(a); MCR ,arts2(a) and 2(b)2; See also similar case which given decisions by the Committee for Resolution of Security Disputes on 1 July 2014 of 1435.
[118] MCR, art3(b).

Application of Law:

The CMA indicted the accused of violating article 49 of the Capital Market Law and articles 2 and 3 of the MCR by his actions.[119] The accused argued that any violation was in ignorance of the law, and not deliberate. It is pertinent to mention at this point the legal maxim '*ignorantia legis non excusat*' (ignorance of the law is not excusable).[120] The CMA rightfully denied the accused's defence, arguing that all the respective laws had been published in the official gazette (raising presumption in favour of knowledge), and thus ignorance of them was not an adequate reason for non-compliance.

(i) Entering purchase orders to influence share prices upwards:

On multiple instances the accused placed a purchase order on the type of stock he already owned. These purchase orders (very few of which were fully or even partially implemented; most were not implemented at all) would then put excess demand on these shares; in speculation other traders would also start purchasing the said stock, driving up sale price, at which point the accused would sell the stock he owned at the inflated prices, as well as cancelling the purchase orders he had initially placed. Article 49(a) of the Capital Market Law prohibits intentional acts which create a false or misleading image of the market or prices of a particular security, or cause a third party to buy or sell it.[121] Article 49(c)(2) in turn mentions that to affect the price of a security in order to induce third parties to buy or sell shall be considered a type of manipulation as prohibited by article 49(a).[122] Thus under article 49(a) as defined by article 49(2)(c) the accused's acts of entering purchase orders, in order to artificially influence share prices upwards and then profiting by selling his own shares at the inflated price, constituted market manipulation and were in breach of the Capital Market Law.[123]

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[119] CML, art49; MCR, arts(2) and (3).

[120] The Law Dictionary, 'What Is Ignorantia Legis Non Excusat?' (*The Law Dictionary*) <http://thelawdictionary.org/ignorantia-legis-non-excusat/> accessed 27 November 2015; Webster Dictionary, 'Ignorantia Legis Neminem Excusat' (*Webster Dictionary*) <http://www.webster-dictionary.org/definition/Ignorantia+legis+neminem+excusat> accessed 27 November 2015.

[121] CML, art49(a).

[122] CML, arts49(a) and 49(c)2.

[123] ibid.

(ii) Entering a purchase order with successive higher prices, higher than the market rate in order to create a false appearance of active trading and high demand (for a particular stock) influencing the share closing price:

On other occasions the accused placed a series of purchase orders with successively higher prices, which were higher than the market rate, in order to falsely create an appearance of the shares being actively traded and having high demand, so as to inflate prices. The increased demand resulted in an upward price spiral, as other traders/investors, noticing the market trend (created by the initial purchase orders), also attempted to purchase shares. The accused then benefited from the inflated price he had caused, selling these shares at the inflated rate (selling shares at a price reasonably higher than the fair market price).

Article 49(a) of the Capital Market Law makes it an offence to intentionally engage in any action, which creates a false or misleading impression of the price of any shares, inducing a third party to buy or sell them.[124] Article 49(c) further lists the types of acts that are considered 'manipulation' under article 49(a).[125] Article 49(c)(2) lists one of these practices as being to affect the price of a security by 'creating actual or apparent active trading or causing an increase or decrease in the prices of such Securities, for the purpose of inducing third parties to buy or sell such Securities'.[126] Thus article 49(a), as elaborated upon by article 49(c)(2), makes the accused's action an offence as the accused entered a series of purchase orders, in a successive pattern of increasing rates, in order to artificially increase trading activity and stock price, inducing third parties to buy his shares.[127]

The MCR further elaborates upon the practices that constitute violations of article 49(a) of the Capital Market Law.[128] Article 2(a) of the MCR prohibits the engaging or participation in any manipulative act in relation to the transaction of securities, and article 2(b)(2) prohibits the creation of an artificial trade price for a security.[129] Article 3(b) of the MCR lists the acts and practices that would be considered manipulative or deceptive for the purpose of creating a false or misleading

[124] CML, art49(a).
[125] CML, arts49(a) and 49(c).
[126] CML, art49(c)2.
[127] CML, arts49(a) and 49(c)2.
[128] CML, art49(a).
[129] MCR, arts2(a) and 2(b)2.

impression.[130] The accused placed successive sale orders at reducing rates and thus his acts fall under article 3(b)(3) of the MCR, which makes the purchasing or making offers to purchase securities, a manipulative or deceptive practice (as required by article 2 of the MCR).[131] The accused has also done this in certain circumstances to establish a high closing price, which in addition to article 3(b)(3) above is a manipulative and deceptive practice under article 3(b)(5) point 2, as required by article 2 of the MCR.[132] The accused actions are deceptive and manipulative as per article 2 (a) (as elaborated upon by articles 3(b)(3) and 3(b)(5) point 2) and article 2(b)(2) of the MCR.[133]

(iii) Entering purchase orders without the intention to execute:

The accused entered a number of purchase orders which he cancelled. These purchase orders were only placed in order to manipulate the market and the accused never had any intention of executing them. Article 3 (b) (5) point 4 of the MCR makes the entering of purchase orders of security that are not intended to be executed a manipulative or deceptive act in itself, when committed with the aim of creating a false or misleading impression as to the trade price or trade activity of a stock.[134] The circumstances mentioned above make it abundantly clear that this was the accused's intention, making this a separate offence.

Case No 91/30 CRSD Decision No 665/L/D1/2009 of 1431 H

Case Facts:

The accused had been a trader since 2003, and was *inter alia* trading in the shares of 24 companies, A to X. The accused maintained two investment portfolios with banks U and Y, the latter being the primary portfolio.

Application of Law:

130 MCR, art3(b).
131 MCR, arts2 and 3(b)3.
132 MCR, arts2, 3(b)3 and 3(b)5.
133 ibid.
134 MCR, art3(b)5.

The CMA indicted the accused of conducting practices that resulted in manipulation and fraud by creating a misleading and false impression, of active trading of the shares of companies, in order to attract investors/traders and benefit from the same, thus violating article 49 of the Capital Market Law and articles 2 and 3 of the MCR.[135]

(i) Entering purchase orders to influence the achievement of a high closing price:

In the course of trading the accused had been entering Purchase Orders so as to influence the share closing price, pushing it upwards. Article 49 (a) makes it an offence to engage in any action which would create 'a false or misleading impression as to the market, the prices or the value of any Security for the purpose of creating that impression'.[136] Article 49(a) is further elaborated upon by article 49(c), which lists the practices that would be considered 'manipulation' as under article 49(a).[137] Article 49(c)(2) states that to affect the price of a particular security though a series of transactions, or causing an increase or decrease in the price of securities, so as to induce third parties to buy or sell, is a manipulative act as meant in article 49(a).[138] Although article 49 does not directly mention influencing the closing price of stock, the text of article 49(a), read with article 49(c), appears wide enough to encompass all circumstances where a stock price is artificially increased or decreased, so as to induce third parties to buy or sell stock.[139] In the particular case, by entering purchase orders the accused aimed to keep pushing the market price of the said stock upwards, until the day ended, resulting in a high closing price. A wide interpretation, as apparent from the construction of article 49, suggests that the accused's actions would constitute manipulation and thus fall foul of the Capital Market Law.[140]

Additionally articles 2 and 3 of the MCR further complement article 49 of the Capital Market Law.[141] Article 2(a) of the MCR forbids the practice of any manipulative act in relation to the transaction of securities, and article 2(b)(2) forbids

[135] CML, art49; MCR arts(2) and (3).
[136] CML, art49(a).
[137] CML, arts49(a) and (c).
[138] CML, arts49(a) and 49(c)2.
[139] CML, arts49(a) and (c).
[140] CML, art49.
[141] CML, art49; MCR arts(2) and (3).

the execution of any order or trade in a security, which creates an artificial trade price for a security.[142] Article 3(b) of the MCR lists the acts and practices that would be considered manipulative or deceptive for the purpose of creating a false or misleading impression. The accused entered purchase orders in order to push up the market value of stock so as to attain high closing prices.[143] Article 3(b)(5) point 2 is very specific as to the present circumstances; it states that entering purchase orders to effect a high closing price constitutes a 'manipulative' act as envisioned under article 2 of the MCR.[144]

(ii) Entering purchase orders to influence share opening prices:

The accused entered purchase orders on multiple occasions in order to spike share prices upwards. The mechanism for this was similar to that of attempting to push up share closing prices. Article 49(a) prohibits any deceptive acts aiming to induce buying or selling of shares by the creation of an artificial price.[145] Although article 49(c) does not directly mention influencing opening price as a manipulative act (which is a prerequisite for there to be an offence under article 49(a)), it does prohibit the creation of an artificial trade price.[146] This was what the accused was doing here. If a wide interpretation were given to the text of article 49 as the text suggests, the accused's actions would be in violation of the Capital Market Law.[147]

The MCR do not directly mention influencing the opening price of stock as a manipulative act. However it is pertinent to note that article 3 expressly states that the practices it mentions will be 'among those considered as manipulative or deceptive',[148] thus not restricting the manipulative acts to those it mentions. Furthermore as article 3(b)(5) point 2 states that entering purchase orders to effect a high closing price constitutes a manipulative act, an analogy can be made between the expressed 'closing price' and 'opening price' as in the current case.[149] The mechanism of achieving artificial closing and opening prices, along with the aim of

[142] MCR, arts2(a) and 2(b)2.
[143] MCR, art3(b).
[144] MCR, arts2 and 3(b)5.
[145] CML, art49(a).
[146] CML, arts49(a) and (c).
[147] CML, art49.
[148] MCR, art3.
[149] MCR, art3(b)5.

inducing trade on the basis of those prices, is the same. Thus it is probable that the artificial inflation of the opening price would also be considered a manipulative act, and the accused would be in violation of article 2 of the MCR as well.[150]

(iii) Entering purchase orders with several amendments to influence share prices upwards:

The accused placed purchase orders on multiple occasions, which would increase share demand. Influenced by the market trend, other traders would also attempt to or start buying shares, which would start pushing the share price upwards. Article 49 (a) of the Capital Market Law prohibits any intentional act or practice which creates a false or misleading image of the market or prices of a particular security, or causes a third party to buy or sell it.[151] In order to attain maximum benefit from his violation, on certain instances the accused would amend the purchase orders as soon as it became likely that they would be executed; in this way the accused could keep pushing the price upwards without having to undesirably have the purchase order executed. Article 49(c)(2) in turn mentions that to affect the price of a security in order to induce third parties to buy or sell shall be considered a type of manipulation as prohibited by article 49(a).[152] Thus under article 49(a), as defined by article 49(2)(c), the accused's acts of entering purchase orders, in order to artificially inflate share prices and then profiting by selling his own shares at the inflated price constitute market manipulation and are in breach of the Capital Market Law.[153]

(iv) Entering purchase orders without the intention to execute:

The accused entered a number of purchase orders and it is abundantly clear from the facts that these were entered only in an attempt to manipulate the market and the stock prices. These purchase orders were never meant to be executed, which is made even clearer by the fact that on various instances when the purchase orders were about to be executed, the accused would alter or amend them, so that they lost priority and were not executed. Article 3(b)(5) point 4 of the MCR makes entering into purchase orders for shares that are not intended to be executed a manipulative or

[150] MCR, art2.
[151] CML, art49(a).
[152] CML, arts49(a) and 49(c)2.
[153] ibid.

deceptive act in itself, when committed with the aim of creating a false or misleading impression as to the trade price or trade activity of a stock.[154] The abovementioned facts clearly show that the accused never intended these purchase orders to be executed, thus he was in breach of article 2 of the MCR, as read with article 3(b)(5) point 4.[155]

<u>Case No 11/30 CRSD Decision No 664/L/D1/2009 of 1431 H</u>

Case Facts:

The two accused persons, M and R, were trading in the shares of company A through the investment portfolio of the father of the second accused, Mr R, at company C. The first accused, M, was the uncle of the second accused, R.

Application of Law:

The CMA accused M and R of actions and practices that were manipulative and fraudulent and caused the occurrence of a deceptive, false and misleading impression about active trading on the company stock, artificially altering its price and inducing investors to trade on it. The primary violations of the accused were:

(i) Entering purchase orders with the aim to influence share closing price:

Most of both the accused's purchase orders were placed within the last few seconds of the trading session. On one occasion a purchase order was entered at the last second. All of these purchase orders were entered with the aim of pushing up the closing price. The Capital Market Law prohibits the creation of any false or misleading impression as to the prices or value of stock or to the market for the purpose of market manipulation.[156] It further explains certain instances which it considers to be manipulation;[157], article 49(c)(2) lists one of these circumstances as being to affect the price of a particular security though a series of transactions or by causing an increase or decrease in the price of securities so as to induce third parties

[154] MCR, art3(b)5.
[155] MCR, arts2 and 3(b)5.
[156] CML, art49(a).
[157] ibid.

to buy or sell it.[158] Article 49 does not expressly classify influencing closing share price as an offence, however article 49(a), read with article 49(c), appears to be constructed and linguistically composed in a manner so as to be interpreted widely, encompassing all circumstances where stock price is artificially increased or decreased, so as to induce third parties to buy or sell stock.[159] The present accused achieved the high closing price by pushing up share market prices during the last few minutes of the trading session, so that the trading session would end when the share price was high. In the particular case, by entering purchase orders, the accused aimed to keep inflating the price of the stock, until the end of the trading session, so as to obtain a high closing price. On a wide construction of article 49 it would appear that the accused's actions would constitute 'manipulation'.

The MCR were promulgated in order to provide guidance and further ease the application of article 49 especially in circumstances such as those of the present case.[160] Article 2(a) of the MCR prohibits 'manipulative' acts in relation to the transaction of securities and article 2(b)(2) proscribes the execution of any order or trade in a security, which creates an artificial price for stock.[161] Article 3(b) of the MCR list the acts and practices that would be considered 'manipulative' or deceptive for the purpose of creating a false or misleading impression.[162] Article 3(b)(5) point 2 specifically applies to the present facts, it expressly makes the entering of purchase orders to attain a high closing price a 'manipulative' act as envisioned under article 2 of the MCR.[163]

(ii) Entering purchase orders so as to push up share price:

The accused entered multiple purchase orders so as to push up the sale price. Entering the purchase order would have a dual effect of not only increasing demand on a particular security but also create the impression of active trading on a particular stock. Both of these would then have a domino effect on other traders, who speculating upon the market future and inspired by the rising trend in the security would start purchasing it, resulting in the starting of a price hike. Article 49(a) of the

[158] CML, art49(c)2.
[159] CML, arts49(a) and (c).
[160] CML, art49.
[161] MCR, arts2 and 2(b)2.
[162] MCR, art3(b).
[163] MCR, arts2 and 3(b)5.

Capital Market Law prohibits any manipulative practices or acts which create a false or misleading impression of the market or prices of securities or induce a third party to buy or sell them.[164] Article 49(c)(2) listing the circumstances that are considered manipulation under article 49(a) states that to affect the price of a security in order to induce a third party to buy or sell it shall be considered a type of manipulation as prohibited by article 49(a).[165] Thus under article 49(a) read with article 49(2)(c) the accused's acts of entering purchase orders, to artificially influence share prices upwards and then profiting by selling their own shares at the inflated price constitute market manipulation and are in breach of the Capital Market Law.[166]

Case No 15/27 CRSD Decision No 43/L/D1/2006 of 1427 H

Case Facts:

The accused was a trader who purchased shares in two companies:

Company A: The accused purchased 5.4 per cent of the shares of company A. Article 30(a)(1) of the Registration and Listing Rules of the CMA require any individual who becomes the owner of 5 per cent or more of any class of shares to notify the issuing company (in this case company A) and the CMA by the end of the trading day.[167] The accused notified the company without delay so that the company may announce this change of ownership. However when the company did not comply, he physically visited the headquarters of the company so as to ensure compliance. The company had delayed compliance due to some internal confusion. Regardless, the accused visited their headquarters again, insisting that the company announce his acquisition of the shares. It is pertinent to mention that the accused's responsibility to notify the issuer had been fulfilled when he informed them the first time. He was under no obligation to ensure that the company further announced it. The company made the announcement on the Tadawul website. On the day of the announcement the accused made a press statement in a question and answer format. In the press statement the accused gave the public the impression that he was a long-term investor, who planned to own an even larger portion of the company's shares and

[164] CML, art49(a).
[165] CML, arts49(a) and 49(c)2.
[166] ibid.
[167] CML, art30(a)1.

aimed to realign company policy towards a more profitable future. As a result of the press release, demand for the company shares increased in the market, pushing up the share price. Two days after the press release the share price hit its maximum. At this point the accused sold a large portion of his shares, so that after the sale he now owned a meagre 1.20 per cent of the shares. The accused did not report this decline in ownership either to the company or to the CMA.

Company B: In a scheme similar to that in relation to company A, the accused purchased 5.29 per cent of company B shares. The company announced the accused's newly acquired ownership, and the accused started selling his shares until his ownership fell to 3.83 per cent. He then gave a press statement to a newspaper falsely claiming that he still owned 5.22 per cent of the company's shares. Additionally in the press statement the accused praised the company's potential, assuring the public that he was a long-term investor, who would change company policy, increasing profits, and encouraged people to buy the shares. The press statement was published the following day and in the afternoon session of this day the accused had sold further shares, reducing his ownership to only 0.38 per cent shares. The following day he sold yet more shares, leaving his ownership at 0.05 per cent.

Application of Law:

The CMA indicted the accused of violating article 49 of the Capital Market Law and article 30 of the Listing Rules of the CMA by committing the following acts and practices:[168]

(i) Misleading people by false actions (that is giving the press statement) and then selling shares to benefit from it:

As is apparent from the facts mentioned above, the accused followed a particular scheme composed of multiple actions to create a false impression about the future of the share prices, profitability and the market, thus pushing the share prices upwards and inducing third parties to buy and sell. The accused created a very similar deceptive scheme for both company A and B. The accused purchased a quantity of

[168] CML, arts30 and 49.

shares for each company, A and B, slightly above the 5 per cent threshold required by article 30 of the Listing Rules of the Capital Market Authority to oblige the companies to make an announcement in regard to his newly acquired ownership. In this manner the accused abused the law to give him credibility and standing in the public's eye, as someone with a vested interest and some control over the company. Once this was done he made a press statement, in which he deceptively and falsely induced people to believe that due to a variety of factors, including the highly lucrative policies he was about to usher in, the company was going to become very profitable. He did this while assuring people that he was there as a 'long-term investor', to guide the company to a profitable future. Thus he raised the public's trust, in him leading the company, as well as directly and indirectly encouraging them to invest in it. As soon as people, deceptively induced to believing in the company's lucrative future, started to buy shares, this spiked the share price high. In the instances of both company A and B, as soon as his deceptive and manipulative false press statements had induced third parties to start buying company stock, the accused started selling his own stock at the inflated prices, making huge profits.

Article 49(a) of the Capital Market Law prohibits any intentional act, such as making press statements, which creates a false or misleading impression as to the market or prices, which causes third parties to buy or sell.[169] Article 49(c) further expands upon the circumstances which are considered manipulation for the purposes of article 49(a); however it expressly only mentions circumstances that involve stock transactions, sale orders, purchase orders, etc.[170] Article 49(c) does not directly list raising share prices through direct false acts or statements as a manipulative act.[171] It is pertinent to draw attention to the wording and construction of article 49(c), which states: 'The following acts and practices shall be among those that shall be considered types of manipulation that are prohibited by paragraph (a)'.[172] The article uses the words 'among those', thus not limiting its scope to the particular acts and practices article 49(c) expressly mentions. Additionally, articles 49(a) and (c) are constructed in a manner so as to encourage being given a wide interpretation. In light

[169] CML, art49(a).
[170] CML, arts49(a) and (c).
[171] CML, art49(c).
[172] ibid.

of the above it is more probable that the accused's actions were 'manipulative' and that he was in violation of article 49.[173]

(ii) Failure to notify when ownership reached 5 per cent:

Article 30(a)(1) of the Registration and Listing Rules issued by the CMA place an obligation upon any individual who obtains 5 per cent shares in a company to notify both the issuing Company and the CMA by the end of the trading day.[174] Article 30(a)(1) imposes a dual obligation upon the 'relevant person' (in the present case, the accused) to notify both the issuer and the CMA.[175] The accused, on acquiring over 5 per cent shares of company A, had failed to notify the CMA. On acquiring 5 per cent shares of company B the accused failed to notify the issuing company and the CMA. He insisted in his defence (to not notifying in case of the violation related to company A) that he had notified the issuing company and it was the duty of the same to further notify the CMA. This defence rightly failed, as it is apparent from the text of article 30(a)(1) that the obligation for both notifications lies with the individual who had newly obtained ownership. Thus the accused is in violation of article 30(a)(1) in both instances of company A and B.[176]

(iii) Failure to notify when ownership reduced by 1 per cent:

Article 30(a)(2) of the Registration and Listing Rules issued by the CMA place a continuing obligation upon any person that falls under article 30(a)(1) (that is anyone who owns 5 per cent or more of any class of voting shares) of notify both the issuing company and the CMA if his ownership increases or decreases by 1 per cent or more of the shares.[177] The accused's ownership of company A fell from 5.4 per cent to 1.2 per cent, and that of Company B from 5.22 per cent to 3.83 per cent to 0.38 per cent to 0.05 per cent. The accused's ownership of the shares of both company A and B

[173] CML, arts49(a) and (c).
[174] CML, art30(a)1.
[175] ibid.
[176] CML, art30(a)1.
[177] CML, arts30(a)1 and 30(a)2.

fell by 1 per cent yet the accused failed to notify the issuer and the CMA, and thus was in breach of article 30(a)(2) in both instances.[178]

Case No 63/30 CRSD Decision No 663/L/D1/2009 of 1430 H

Case Facts:

The accused was a trader who operated both his and his wife's portfolios and *inter alia* traded in the shares of company A and B. Using these portfolios he entered a number of sale and purchase orders. Additionally he also conducted certain transactions between the two portfolios.

Application of Law:

The CMA indicted the accused of violating article 49 of the Capital Market Law and articles 2 and 3 of the MCR by committing the following acts and practices:[179]

(i) *The accused entered sale and purchase orders which concluded to result in transactions with the aim of increasing share price*:

The accused used two portfolios in order to conduct his trading business. On multiple occasions he placed purchase or sale orders from one portfolio, closely followed by a sale or purchase order by the other, in such similar terms that the purchase to sale or sale to purchase orders would correspond and a transaction would be concluded between the two portfolios. These transactions (also referred to as 'wash sales'[180]) would result in a false impression of increased activity and higher demand for the said securities. Other traders who were deceived and manipulated by the accused's actions, would start attempting to buy the said securities and this would lead to an upwards price spiral. Article 49(c)(1)(a) states that any transaction in securities which does not involve a 'true transfer of ownership', shall be considered manipulation under article 49(a).[181] Additionally article 49(c)(1)(c) states

[178] CML, art30(a)2; See also similar case which given decisions by the Committee for Resolution of Security Disputes on 15 July 2014 of 1435.
[179] CML, art49; MCR, arts(2) and (3).
[180] A 'wash sale' is a sale of securities made at about the same time period as a purchase of the same securities (such as within 30 days), resulting in no change in beneficial ownership: *Black's Law Dictionary* (West, 2009) 1456.
[181] CML, arts49(a) and 49(c)1(a).

that the entering of a sale order with 'prior knowledge' that a purchase order of substantially the same size, price, time etc.[182] for the sale of the same shares will be entered by the same party would also be considered a type of manipulation as required under article 49(a).[183] Furthermore article 49(c)(2) makes it an offence to affect the price of a security by conducting a series of transactions which create a false appearance of active trading, or altering the price of such securities so as to influence third parties to trade in it.[184] As mentioned, the accused set corresponding purchase and sale orders to conclude transactions for exactly this purpose. Thus in addition to articles 49(c)(1)(a) and 49(c)(1)(c) the accused's actions were also manipulative under article 49(c)(2) putting him in violation of article 49(a).[185]

Article 2 of the MCR (which further elaborates upon the Capital Market Law) also prohibits, similarly to article 49, the committing of any manipulative practice in connection to an order of transaction of security.[186] Article 2(b) also forbids the execution of any order which leads to a misleading impression of trading activity or an artificial bid price.[187] Article 3 further mentions the types of practices that constitute 'manipulative' as required under article 2.[188] Article 3(a) states that any fictitious trade, or one where there is no transfer of 'beneficial ownership', will be manipulative, as required under article 2.[189] Thus the accused is also in violation of article 2(b) read in conjunction with article 3 of the MCR.[190]

(ii) The accused entered purchase orders so as to influence a higher closing price of the shares:

The accused entered purchase orders on multiple occasions, primarily towards the end of the trading session, with the aim of influencing the share closing price upwards. His entered purchase orders would falsely create an appearance of increased demand as well as trading activity, which would increase the share price. The accused's actions were in violation of article 49(a), which makes it an offence to

[182] CML, art49(c)1(a).
[183] CML, art49(a).
[184] CML, art49(c)2.
[185] CML, arts49(a), 49(c)1(a), 49(c)1(c) and 49(c)2.
[186] CMR, art2; CML, art 49.
[187] CMR, art2(b).
[188] CMR, arts2 and 3.
[189] MCR, arts2 and 3(a).
[190] MCR, arts2(b) and 3.

engage in any practice, 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'.[191] Article 49(c) further lists the practices considered to be 'manipulation' as required under article 49(a).[192] Article 49(c)(2) states that to affect the price of a specific stock through a series of transactions or causing an increase or decrease in the price of stock, so as to induce third parties to buy or sell is a manipulative act as meant in article 49(a).[193] Even though article 49 does not expressly mention influencing the closing price of stock, article 49(a), read in conjunction with article 49(c), appears wide enough to encompass all instances where stock price is artificially increased or decreased, so as to induce third parties to buy or sell the stock. In the particular case by entering purchase orders the accused aimed to keep pushing the market price of the said stock upwards until the day ended, resulting in a high closing price. A wide interpretation as suggested by the text of article 49 would be that the accused's actions were manipulative, thus falling foul of the Capital Market Law.[194]

Articles 2 and 3 of the MCR further complement the Capital Market Law.[195] Article 2(a) of the MCR forbids the practice of any deceptive or manipulative act in relation to transaction of securities and article 2(b)(2) forbids the execution of any order or trade in a security, which would alter the trade price of a security.[196] Article 3(b) of the MCR lists the acts and practices that would be considered manipulative or deceptive for the purpose of creating a false or misleading impression.[197] The accused entered purchase orders in order to push up the market value of stock, so as to reach a high closing price and is expressly dealt with article 3(b)(5) point 2,[198] which states that entering purchase orders to attain a high closing price constitutes a 'manipulative' act as envisioned under article 2 of the MCR.[199]

(iii) The accused entered purchase orders with successive high prices to influence share price:

[191] CML, art49(a).
[192] CML, arts49(a) and (c).
[193] CML, arts49(a) and (c)2.
[194] CML, arts49(a) and (c).
[195] MCR, arts2 and 3.
[196] MCR, arts2(a) and 2(b)2.
[197] MCR, art3(b).
[198] MCR, art3(b)5.
[199] MCR, art2.

In addition to attempting to influence share closing prices, the accused placed a series of purchase orders at successively high prices so as to create an appearance of the company shares being actively traded and having high demand, so as to increase prices. The increased demand pushed up prices in an upward cycle, as other traders influenced by the market trend also attempted to purchase shares. Capitalizing on the artificial price spiral he had created, the accused started selling his shares at the inflated market price.

Article 49(a) of the Capital Market Law proscribes any intentional act which creates a false or misleading impression of the price of any stock inducing a third party to buy or sell.[200] Article 49(c) further lists the types of acts considered 'manipulation' under article 49(a).[201] Under article 49(c)(2) one of these acts is affecting the price of a security by 'creating actual or apparent active trading or causing an increase or decrease in the prices of such Securities, for the purpose of inducing third parties to buy or sell'[202] As can be seen from the above, article 49(a), read in conjunction with article 49(c)(2) make the actions of the accused (entering a series of purchase orders in a successive pattern of increasing rates, to artificially increase trading activity and share price, inducing other traders to buy or sell) a breach of the Capital Market Law.[203]

The MCR set out for the purpose of complementing the Capital Market Law elaborates upon it. Article 2(a) of the MCR forbids the engaging or participating in any manipulative act in relation to a transaction of securities and article 2(b)(2) forbids the creation of an artificial trade price for a security.[204] Article 3(b) of the MCR list the acts and practices that would be considered manipulative or deceptive for the purpose of creating a false or misleading impression.[205] The accused has placed successive purchase orders at increasing rates and thus his acts fall under article 3(b)(3) of the MCR.[206] This makes the purchasing, or making offers to

200 CML, art49(a).
201 CML, arts49(a) and (c).
202 CML, art49(c)2.
203 CML, arts49(a) and 49(c)2.
204 MCR, arts2(a) and 2(b)2.
205 MCR, art3(b).
206 MCR, art3(b)3.

purchase securities, a manipulative or deceptive practice (as required by article 2 of the MCR).[207]

The accused's actions were deceptive and manipulative under article 2(a) read in light of articles 2(b)(2) and 3(b)(3) of the MCR.

(iv) The accused entered purchase orders so as to influence share opening prices:

In the course of trading, the accused has been entering purchase orders using both the portfolios (both his own and that of his wife) so as to influence the opening price, pushing it up. These purchase orders were entered prior to market opening and had successive higher rates so as to push up the share opening price. Article 49(a) prohibits the engaging in any action, which would create 'a false or misleading impression as to the market, the prices or the value of any Security for the purpose of creating that impression'.[208] Article 49(a) is to be read in conjunction with article 49 (c), which explains 'manipulative' practices as required by article 49(a).[209] Article 49(c)(2) categorizes the affecting of the price of a class of shares, by the conducting of a series of transactions or to cause an increase or decrease in their price, in order to induce third parties to buy or sell a manipulative act (as required under article 49(a)).[210] Although article 49 does not directly mention influencing the opening price of stock, the text of article 49(a), read along with article 49(c), appears wide enough to encompass all circumstances where stock price is artificially increased or decreased, so as to induce third parties to buy or sell stock.[211] In the case in question, by entering purchase orders before the beginning of the trading session, the accused aimed to generate artificial demand and the appearance of trading activity, so as to induce third parties to place purchase orders, hence raising the opening trade price before the beginning of the trading session. A wide interpretation as apparent from the construction of article 49 suggests that the accused's actions would constitute manipulation and thus fall foul of the Capital Market Law.[212]

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[207] MCR, art2.
[208] CML, art49(a).
[209] CML, arts49(a) and (c).
[210] CML, arts49(a) and 49(c)2.
[211] CML, arts49(a) and 49(c).
[212] CML, art49.

Furthermore article 2(a) of the MCR (building upon article 49 of the Capital Market Law) forbids any manipulative act or practice in relation to the transaction of securities and article 2(b)(2) forbids the execution of any order or trade in a security, which creates an artificial trade price.[213] Article 3(b) of the MCR helps interpret article 2 by listing the acts and practices that would be considered manipulative or deceptive for the purpose of creating a false or misleading impression.[214] Multiple purchase orders have been entered by the accused before the start of the trading session with the intent of artificially inflating the opening price. Although the MCR does not expressly mention influencing the opening price as a manipulative act, article 3 states that the acts it mentions will be 'among those considered as manipulative or deceptive'[215] thus not limiting the circumstances to those it mentions. Article 3 (b)(5) point 2 states that entering purchase orders to effect a high closing price constitutes a manipulative act; an analogy can thus be made between it mentioning 'closing price' with that of 'opening price', as in the present case.[216] The mechanism of achieving of an artificially inflated closing price and opening price, as well as the effects of both on the market, are very similar. Thus it is probable that the artificial inflation of the opening price would also be a manipulative act and the accused would be held to be in violation of article 2 of the MCR as well.[217]

(v) The accused entered purchase order with the intent to not execute:

The accused also entered purchase orders with the intent of manipulating the market, and never had any intention to execute them. Article 3(b)(5) point 4 of the MCR makes entering into purchase orders for securities that are not intended to be executed a manipulative or deceptive act in itself, when committed with the aim of creating a false or misleading impression in regard to the trade price or trade activity of a stock.[218] The facts of the case make it abundantly clear that the accused's intent was never to have these purchase order executed, and thus his acts amount to being deceptive and manipulative, making him in breach of the MCR.

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213 CML, art49; MCR, arts2(a) and 2(b)2.
214 MCR, arts2 and 3(b).
215 MCR, art3.
216 MCR, art3(b)5.
217 MCR, art2.
218 MCR, art3(b)5.

2.10 Conclusion

Stock markets are an invaluable medium between the public and the commercial industry, acting as a conduit for the investment of funds. They provide a means for investors and traders to invest in profitable companies and divest from unprofitable ones. However stock markets are exceptionally vulnerable to white collar crimes, such as market manipulation and insider trading. Instances such as the Worldcom and Enron scandals bring to light the serious risk these practices pose to the entire economy.[219] The Saudi Arabian stock market in its current form is still nascent and developing. The Saudi authorities, realizing the necessity for safeguarding the stock market and all stakeholders, have promulgated a series of laws including the Capital Market Law, the MCR and the Registering and licensing rules. However as is apparent from the cases discussed above, on multiple occasions the accused were indicted after numerous offences had already been committed. If the stock market is to be adequately protected, the Saudi authorities need to improve enforcement of the promulgated laws, by better monitoring of the stock markets. The following chapter will attempt to understand this phenomenon of market manipulation from an Islamic perspective.

[219] Financial Institutions and Markets (n 95) 196.

CHAPTER 3: THE ISLAMIC LAW OF MARKET MANIPULATION

3.1 Introduction

The purpose of this chapter is to investigate market manipulation from an Islamic perspective. This chapter is divided into four sections. The first section discusses and defines Islam as a religion, and its legal sources. Here, in the context of Islamic Law, it will examine the Qur'an and the Sunna as primary Islamic legislative sources, as well as the *Ijma* and the *Qiyas* as secondary Islamic law sources. The second section analyses Islamic objectives. The third section studies whether or not principles of market manipulation supplemented in Islamic law attain their purpose. Finally, a summary is provided.

3.2 The Legislation System in Islamic Law

Legislation conecerning the justice system, particularly with regard to basic rules and provisions in the field of private rights, with its two branches, civil and criminal. In Islamic law, legislation for these fields is based on original Islamic legal texts and scripture such as the Holy Qur'an and the Sunnah,[1] the teachings of which underlie the basic principles and, in the interests of saving time and space, leave the application of law to new or novel situations open to discretion and individual interpretation.[2] There are, however, a few detailed prescriptions on how to proceed with specific legal situations such as inheritance, and punishments for particular crimes.[3]

It is important to note, however, that the application of legislation in these fields is far from uniform across the Islamic world. Due to the divergence of cultures across ancient civilizations and the greatly varying economic conditions of different Islamic countries, a spectrum of highly inconsistent and diverse interpretations of Islamic law has developed from the general principles prescribed in the original texts (the Qur'an and the Sunnah); scholars, commentators and magistrates frequently debate

[1] The Qur'an and the Sunnah are explained later in this chapter.
[2] Majid Khadduri, 'Nature and Sources of Islamic Law' (1953- 1954) 22 The George Washington Law Review1,3.
[3] Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence* (Islamic Texts Society 2003) 18; Mū'il Yūsuf 'Izz al-Dīn, *Islamic Law* (University of Notre Dame Press 2005) 37.

which interpretations most closely represent the 'original law'.[4] Aside from this tendency of experts to interpret laws differently, Islamic law was, for a long time, one of the fairest and most respected and widely applied legal systems known in the history of law, and many doctrines have been developed from it, the most of famous of which are the four schools of jurisprudence: Hanafi, Maliki, Shafi'i and Hanbali, which survive to this day. The differences between these four schools are not merely regional but theoretical, resulting from a great revolution of thought within Islamic jurisprudence.[5]

3.3 The Fundamental Principles of Islamic Law

3.3.1 Civilian Rights (Transactions)

Islamic law considers every action that is harmful to others as necessarily the responsibility of the offender, obligating him or her to compensate the victim for damages, caused even in cases where the damage was accidental.[6] A punishment for the offence was also integrated into the legislation, in line with the teachings of the Hadith 'There should be neither harming [*darar*] nor reciprocating harm [*diraar*].'[7] Moreover, in Islamic Law all obligations are thus strictly upheld and supported by the judiciary.[8] Judges, for instance, have wide and unlimited powers with which they can enforce the carrying out of a person's obligations, even those of the Caliph himself. In fact, situations where judgments have been passed on caliphs and kings are frequent and well-known throughout Islamic history.[9]

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[4] Mazhar-ul-Haq, *A Short History of Islam: From the Rise of Islam to the Fall of Baghdad* (Bookland, 1977) 387-388; Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence* (Islamic Texts Society 2003) 18.

[5] Ibn Rushd Alhafid, *Aljamia Almofeed fee Asbab Akhtlaf Alfuqha* (Arabic edition, Dar Ibn Hazm 2009).

[6] Mustafa Alzarqa, *Almadkhal Al-Fighi Alaam* (Arabic edition, Dar Al-Qalm Publisher, Damascus) 56–57.

[7] Imam Malek mentioned this in *Almuwataa* (from Amr Ibn Yehya from his father, judgments chapter in Almarfek). It was also mentioned by Ibn Maga, quoted from a speech by Ebada Ibn Alsamet (2340), with parts omitted, and is alluded to slightly in Gaber Algafry's speech (2341) as well as being mentioned by Aldarqtany, Alhakm and Alboheqy, who quote a speech by Abu Sae'd Alkhodry. As Alnawawy said in AlArba'en, Speech 32: 'It has methods that strengthen (compliment) each other' and Ibn Saleh said that the authenticity of this speech was proven by Aldarqtany. A group of scientists accepted it and used it as an argument.

[8] Alzarqa (n6).

[9] Alzarqa (n6).

3.3.2 Commercial Contracts in Islamic Finance

Islamic law allows for contracts based on the following principles.

First, the upholding of a legal contract is considered an obligation of the contractor, and also the confession of a person is applied just for himself and his rights (as legitimate evidence).[10] In inheritance law, the obligation of the contract itself is to ensure that inheritance is transferred from the contractor to the inheritor or other recommended person, and this principle is included in the Qur'anic verse at the begging of Sort El-Maida, which says: 'O you who believe! Fulfil your undertakings.'[11]

Secondly, the conditions of a contract may be arbitrary, and the fulfilment of these conditions obligatory for the contractor, so long as what is contracted is not detrimental to society or accepted morals. This principle is illustrated through the Hadith, which says that 'Muslims are obligated by all conditions except those which make *Haram* things *Halal* and *Halal* things *Haram*'.[12]

Thirdly, in order for a contract to be satisfied, all that is required is the consent of both parties no formal ceremony is necessary. Even marriage contracts require only the satisfaction of the man and woman concerned and the attendance of two witnesses.[13] Historically, contracts created by Romans as well as some made by Arabs, were formal contracts, whereby those involved would be subjected to ceremonies and strange movements, even if both parties were dissatisfied. This formality of contracts continued to exist in Rome in of human rights until the end of the eighteenth century, when the only requirement for a contract to be created became the satisfaction of all parties involved.[14]

[10] Noor Mohammed, 'Principles of Islamic Contract Law' (1988) 6 Journal of Law and Religion, 115-116; Mohd Daud Baker, Contracts in Islamic Commercial and Their Application in Modern Islamic Financial System (International Islamic University Malaysia) 2. <http://www.kantakji.com/media/5343/y116.pdf> accessed 22 October 2015.

[11] Holy Qur'an, Surat El-Maida (5), Ayah 1(King Fahd Complex for the Printing of the Holy Qur'an); Baker (n10) 2.

[12] Narrated by Abu Dawood ,Hadith number: 3594 (Darussalaam for Publication and Distribution, Saudi Arabia 1999) ; Altirmidhi ,Hadith number: 1352 (Darussalaam for Publication and Distribution, Saudi Arabia 1999) After this Hadith Imam Altirmidhi said this Hadith is Hassan Saheeh (acceptable but not as high as Saheeh).

[13] Alzarqa (n6).

[14] Mohammed (n10)115–116.

Fourth, Islamic law erquires that the establishment and execution of a contract be made with good intent, enabling the contractor to breach the requirements of the contract should it be found that the creator of the contract acted fraudulently.[15]

Fifth, Islamic law considers customs and habits fundamental in determining the specifics of contractual agreements. For example, the decision about the method by which the contractor is paid is left to the custom and discretion of the contract creator.[16]

Customs are also highly important in the judicial consideration of almost every situation, unless such customs contradict Islamic legal texts, such as the obligation of an individual to pay off a gambling debt.[17]

3.3.3 Criminal Law (Crime and Punishment)

Islamic law supports a system of punishment based on two principles:

1) Every prohibited action is considered a crime, and it is obligatory for every crime to be punished in a manner which is proportional to the original offence and enough to ensure the future discipline of the offender and to maintain the internal security of the state. A new punishment can thus be given even if Islamic law has not determined a specific punishment for an action.[18]

2) Islamic law leaves the punishment of most crimes (except for five) at the discretion of the judge, to allow for consideration of the unique circumstances of the crime. These punishments, which Islamic laws did not detail, are called: *Ta `zir*.[19]

In cases of aggression or violence in particular, Islamic law specifies that the punishment must be identical to the crime. For example, it decrees that a killer must

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15 Alzarqa (n6).
16 ibid.
17 Jonathan Ercanbrack, *The Transformation Of Islamic Law In Global Financial Markets* (Cambridge University Press 2015) 50–53.; H. Hassan, 'Contracts In Islamic Law: The Principles of Commutative Justice And Liberality' (2002) 13 (3) Journal of Islamic Studies, 257, 257–259; M. E. Hamid, 'Islamic Law of Contract or Contracts' (1969) 3 Journal of Islamic and Comparative Law, 1-6.
18 Alzarqa (n6).
19 ibid.

be killed, providing that the relatives of the deceased agree with this. If they choose to forgive the perpetrator, then the judiciary must respect this, although a lesser punishment is usually issued.[20]

3.4. Sources and Methods of Islamic law

3.4.1 The Holy Qur'an as a Primary Source

The Holy Qur'an lays the foundation for legislation, and its instruction on issues such as personal rights and worship are detailed in Islamic doctrine.[21] Islamic doctrine teaches that national laws should be based on the example of the Prophet Muhammad (peace be upon him) and accordingly, the main source of doctrine is the Holy Qur'an itself.[22] The Holy Qur'an is God's Words. It was revealed to Prophet Muhammad over a period of twenty-three Hijra years (610–632). Details and specifics are left to the discretion of those in authority, since to instruct on every possible conceivable issue would make the Qur'an convoluted; one has to decipher the meaning behind the figurative language of the general principles of the Qur'an if guidance is required on an uncommon issue.[23]

Instructions on how prayer should be conducted and the administration of *zakat* (charity) is detailed in the Sunnah, (an account of the sayings and actions of the Prophet (peace be upon him).[24]

The Qur'an also prohibits usury and commands that contracts must be fulfilled, regardless of the particular terms of the contract.[25] Examples of invalid and *Haram* contracts are illustrated in the Sunnah. Certain details are however, elaborated on in important provisions or topics, such as the punishment that will befall women who commit incest. These details are of particular importance in provisions for civilian

[20] ibid; Abdulkader Owdeh, *Al- Teshrea' Al- Gena'ee Al-Islami* (Dar ALkutab Alarabi) Pt 1, 66-70; Reza, Sadiq , Due process in Islamic criminal law (2013) 46(1) The George Washington International Law Review 1,1-4; Mohamed Elewa Badar, 'Islamic Law (Shariah) And The Jurisdiction Of The International Criminal Court' (2011) 24 (2) Leiden Journal of International Law 411-413.
[21] The majority of Muslims consider that there are four primary courses which are the Qur'an, the Sunnah, *Ijma* and *Qiyas* and this one of method. Another method which consider the Qur'an just the primary source and other are secondary sources. For more details see: Ali Alamadi, Al'iihkam *Fi 'Usul Al'ahkam* (Dar Alssamiei 2003).
[22] Mohammad Hashim Kama, *Principles of Islamic Jurisprudence* (Islamic Texts Society 2003) 245.
[23] Alzarqa (n6) 73.
[24] ibid.
[25] Mohammad Ayub, *Understanding Islamic Finance* (John Wiley & Sons 2007) 44-45.

transactions and political and societal systems. Changes which occur in society or culture over time can be accommodated through an evolution in how the texts are interpreted. This is one of the advantages of the general broadness and vagueness of the Qur'an. For instance, the Qur'an does not hold an importance to the type of political system or the position on the political spectrum that the leading party at any given time holds; it simply prohibits any form of tyranny. Similarly, no provisions are made for the prevailing hierarchy of courts at a given time. Only general principles around how the justice system should be established and which decisions are authentic according to Islamic law. Any 'gaps' in the Qur'an around guidance on particular and specific issues were intended to be covered by the development of the Hadith and the diligence of the famous scholars.[26]

The Qur'an provides three categories of rules:

1- Tent or creed rules: rules concerning belief and faith in God, Angels, Holy Books, Messengers and the Day of Judgment.
2- Moral and ethical rules: rules concerning virtues and vices.
3- Practical rules: rules concerning the practice of an individual Muslim. This type organizes two aspects: (a) rules concerning worship such as prayer, fast and pilgrimage, which aim at organizing the relationship between God and man, (b) dealing rules concerning contracts, conduct and punishments, which aim to organize relationships both between individuals and between nations.[27]

The Qur'an therefore recommends and refers the reader to the Sunnah to obtain these details: 'So take what the Messenger assigns to you, and deny yourselves what he withholds from you.' The Sunnah is, thus, a key part of the Qur'an.[28]

On the other hand, we can see below how the Qur'an prohibited manipulation; the main radix Islamic law texts ruled in relationship and transactions is fairness and forbidding oppression; whatsoever almighty God authorized in transactions surely

[26] Alzarqa (n6) 74.
[27] Abdulrahman Al-Homady, *Al-Qadi' Wa Nedamoh Fi Al-Kitaab Wa Al-Sunnah* (Arabic edition, Om Al-Qura' University Publisher 1989) 329–330.
[28] Alzarqa (n6) 74.

contains fairness and reforms peoples' problem, anything forbidden (made *Haram*) for sure does contain oppression and depravity.[29]

Almighty of Allah:

> And to Madian, their brother Shu'aib. He said: 'Worship Allah, my nation, for you have no god except Him. A clear sign has come to you from your Lord. Give just weight, and full measure; and do not diminish the goods of people. Do not corrupt the land after it has been set right, that is best for you, if you are believers.'[30]

Almighty of Allah:

> Do not consume your wealth between you in falsehood; neither propose it to judges, in order that you sinfully consume a portion of the people's wealth, while you know.[31]

Almighty of Allah:

> Allah orders you all to hand back trusts to their owners, and when you judge between people you judge with justice. Indeed, the best is the exhortation with which Allah exhorts you. Allah is the Hearer, the Seer.[32]

Almighty of Allah:

> Believers, do not consume your wealth among yourselves in falsehood, except there be trading by your mutual agreement. And do not kill yourselves. Allah is the Most Merciful to you.[33]

Scholar Al-Kortobi said in the interpretation of the above verses:

> Do not consume wealth of each other illegally and this include gambling, cheating, unlawfully seizing and denying rights of each other, or anything the owner will not be happy for you to take, or anything that Islamic law forbade even if the owner is happy for you to take such as money gained through prostitution, witching.[34]

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[29] Abdulah Alumrani, Market Manipulation on Financial Market, Arabic edition (International Islamic Fiqh Academy, Muslim World League 2010).
[30] Holy Qur'an, Surat Al-A'raf (7), (n 11).
[31] Holy Qur'an, Surat Al-Baqarah (2), Ayah 188, (n 11).
[32] Holy Qur'an, Surat Al-Nisa (4), Ayah 158, (n 11).
[33] Holy Qur'an, Surat Al- Nisa (4), Ayah 29, (n 11).
[34] Mohammed Alkortabi, *Tafseer AlKortobi, Al Jam'e Lee Ahkam Al Qur'an* (Arabic edition Alresalah Company) Pt 2, 338.

Scholar Zamakhshari said: ‘This is what ‘Islamic law’ did not allow such as theft, cheating, gambling and interest contracts.’[35]

The Prophet Mohammed (peace be upon him) said: ‘There should be neither harming [*darar*] nor reciprocating harm [*diraar*].’[36]

Imam al-Shäfi`i, the eponym of the Shäfi'i school of Islamic jurisprudence had stated that:

> Basically all trading is lawful if both of its parties are lawfully and happily able to trade except what the Prophet disallowed directly or indirectly, a part of this I authorize it as it is been described in the Qur’an.[37]

Scholar Ibn Taymiya said:

> In general all what the holly book or teachings of the Prophet forbade would lead to this establishment of justice, and prevent oppression no matter how small or how big it is i.e. consuming unlawfully wealth of others including moneylending [interest], gambling, seducing sale, what is in the womb, selling birds or fish while still free, selling with an indefinite time to pay, selling non-milked animal, deciding to sell just by touching (just feeling the item by hand without making sure about the quality), or swapping things (without making sure they are equivalent to each other), selling not yet ready fruits with similar ready ones, selling fruits before its growth and other false partnerships such as lending an empty land to someone to cultivate it in return give a proportion (i.e. a third or a quarter) of the crop after harvesting.[38]

And any other practices or behaviours of some professional speculators in the stock market such as misleading, manipulating and cheating clients are included in the forbidden oppression.[39]

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[35] Zamakhshari Abu Kassim, *Tafseer Alkashaaf* (Arabic edition, Dar ALkutab Alarabi, Beirut) Pt 1, 533.

[36] Malek mentioned this in ‘*Almuwataa*’ (from Amr Ibn Yehya from his father, judgments chapter in *Almarfek*). It was also mentioned by Ibn Maga, quoted from a speech by Ebada Ibn Alsamet (2340), with parts omitted, and is alluded to slightly in Gaber Algafry’s speech (2341) as well as being mentioned by Aldarqtany, Alhakm and Alboheqy, who quote a speech by Abu Sae'd Alkhodry. As Alnawawy said in ‘*AlArba'en*’, Speech 32: ‘It has methods that strengthen [complement] each other’ and Ibn Saleh said that the authenticity of this speech was proven by Aldarqtany. A group of scientists accepted it and used it as an argument.

[37] Mohammed Al-Shäfi`i, *Kitab Al-Umm, (*Arabic edition, Dar ALfikr, Beirut, 1990) Pt 3, 3.

[38] Ahmed Ibn-Taymiya, *Majmu Alfatawi*, Arabic edition (Dar al Wafa and Dar Ibn Hazm) Pt 28, 385.

[39] Said Buharawa, ‘Market Manipulation in Financial Market’, Arabic edition, (International Islamic Fiqh Academy, Muslim World League, 2010); Abdullaah AlSulamee, Engaging in Deceptive Practices in the Stock Exchange (2008) 41 (Al-Adl Journal – Ministry of Justice, Saudi Arabia) 1, 135–145.

3.4.2 The Sunnah as a Primary Source

The word ‘Sunnah’ refers to the sayings or actions reliably attributed or proven to belong to the Prophet (may God’s peace be upon him);[40] in this sense, it is equivalent to the Hadith, but treated more seriously, since the Sunnah was transcribed during the Prophet’s era, making it more ‘authentic’ and ‘real’ and giving it greater authority in the application and practice of Islamic law.[41]

Imam al-Shäfi`i had stated:

> The Sunnah of the Prophet is of three types: first is the Sunnah, which prescribes the like of what God has revealed in His Book; next is the Sunnah which explains the general principles of the Qur'an and clarifies the will of God; and last is the Sunnah where the Messenger of God has ruled on matters on which nothing can be found in the Book of God.[42]

The Sunnah is also more reliable in that it is viewed as the pure, unadulterated form of the word of the Prophet (God’s peace be upon him), whereas the Hadith is what was transcribed and copied down at the time but perhaps in an inaccurate manner. Scholars have proven that people working within the Prophet’s era or in the realm of the rightly guided Caliphs were conducting themselves in a way that the Sunnah would not have instructed. In other words, the Hadith says one thing but the Sunnah says another.[43]

If the Sunnah and Hadith are both right then a balanced view corresponding to both teachings must be struck. In the case of irreconcilable contradictions between the two, one of them must be favoured over the other, somewhat arbitrarily. The same

[40] ‘Proven’ means that if the Prophet Muhammad (peace be upon him) had done or said something to any one (or someone did anything and the Prophet knew it, and did not deny or forbid it). See: Mohammed Al dhahaby, *Almowqetha Fee Mustalah Alhiddith*, (Arabic edition Dar Auhed 1994).
[41] Hadith Mainly is narration and the Sunnah is the interpretation of Hadith. This is well described in the sayings of Abdul Rahman Ibn Mahdy when he was asked about Abu Sofian Althawry, Alawzaa'y and Malek: ‘Sufian is a scholar in the Hadith but not a scholar in the Sunnah, and Alawzaa'y is a scholar in the Sunnah but not a scholar in the Hadith; Malek is a scholar in both of them.’. See: Alzarkany *Explanation in Almwataa' Malek* (Arabic edition Maktabt Althaqafah, 2003); Ali Hasan Abdul Kader, *A General Review of Islamik Feqh History* (Arabic edition Dar Alkutub Alhadeetha, 1965) 116.
[42] Mohammed Al-Shäfi`i, *al-Risälah* (Arabic edition Mustafa alhalabi 1983) 52-53.
[43] Abdulrahman Al-Homady, *Al-Qadi' Wa Nedamoh Fi Al-Kitaab Wa Al-Sunnah* (Arabic edition, Om Al-Qura' University Publisher, 1989) 341; Alzarqa (n6)75-76.

applies to two conflicting Hadiths: a follower must choose between them at his discretion.[44]

The Sunnah is considered after the Holy Qur'an in legislation, covering what is not mentioned in the overall statement. It is also an independent source of legislation from the Qur'an, since it may include provisions, which are not mentioned in the Holy Qur'an such as the inheritance a grandmother is entitled to. It has been proven that the Prophet said that the grandmother of the deceased should take a sixth of the assets. It should be noted that the Sunnah is always subordinate to the Qur'an, never conflicting with the general rules and principles but merely clarifying or furthering Qur'anic statements.[45]

The Sunnah in general is necessary for understanding the Qur'an and cannot be neglected in understanding and applying its teachings, even where instructions are given on matters unrelated to those in the Qur'an.[46] The Sunnah evolution ended with the death of the Prophet, but it had been transmitted through generations verbally. Now to accept a fact as the Sunnah and be endorsed in the legislation jurisprudence, it must satisfy very strict conditions that the Sunnah scholars adopt to distinguish true Hadiths from false ones and rank them in different levels.[47]

3.4.2.1 How the Sunnah Prohibits Manipulation

We can see below in more detail how the Sunnah prohibited manipulation.

The first evidence for prohibited market manipulation appears from *Al-Najash*: *Al-Najash* is when a high price is bid without an intention to buy, but to raise the price so that the seller gets more benefit and the buyer is harmed.[48]

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[44] ibid.
[45] Hisham M Ramadan, *Understanding Islamic Law* (AltaMira Press 2006), 4–5; Umar Sulaymān al-Ashqar, *al-Madkhal ilá al-sharī'ah wa-al-fiqh al-Islāmī*, Arabic edition (Dār al-Nafā'is lil-Nashr wa-al-Tawzī', 2005) 123–24.
[46] Umar Sulaymān al-Ashqar (n44)124–25.
[47] Bernard G Weiss, *Studies in Islamic Legal Theory* (Brill 2002), 25–29; H. Patrick Glenn, *Legal Traditions Of The World* (Oxford University Press 2000) 198-201; "Sunnah" in John L Esposito (ed) 'In The Islamic World: Past and Present' (Oxford Islamic Studies Online) <http://www.oxfordislamicstudies.com/article/opr/t243/e332> accessed 19 November 2015
[48] Muhammad Ibn Rushd, *Bidayat al-Mujtahid*, Arabic edition (Dar Ibn Hazm 1999) Pt 2, 125.

Imam Shafi' described *Al-Najash*: 'when the item is for bidding and someone offers a price without intending to buy it, just to make the others follow him, so they make higher offers.'[49] Even if they did not hear him, his intention alon makes him a sinner.

1) Evidence from Hadith (Prophets' teachings) to inhibit Najash

a) Ibn Omar narrated that the Prophet (peace be upon him) inhibited *Najash*. In *Muatta'* (book of scholar Malik) *Najash* is defined as offering the seller a higher price than what is deserved, without intention to buy, just to stimulate others to offer more.[50]

b) Abu Hurairah said: 'the Prophet forbade that a man in the city should be commissioner of a man in countryside and prohibited *Najash* and that a man makes an offer to sale while his brothers' is pending or makes a proposal for marriage while his brothers is pending or a woman should try to make her sister divorced to take her place.'[51]

2) Other evidence inhibiting Najash

a) Omar Ibn Al-Khattab, the second Caliph, said: '*Najash* is not allowed and the sale has to be reversed.'[52]

b) Abdullah Ibn Abi Awfa said: 'the one who practises Najash is a usury eater and a cheater, and *Najash* is a void deception that is not allowed.'[53]

The wisdom behind the forbidding of *Najash* is because it contains injustice, unfairness and stimulates others to make the seller gain more profit or to harm the buyer or both, and because it is a sort of deception.

Ibn Kutaiba said: '*Najash* is deceitfulness and deception.'[54] Scholar Albajy in the expounding of *Almuatta'* said: 'the Prophet prevented *Najash* because it is a sort of

[49] Mohammed al-Shawkaani, *Neil al-Awtaar*, Arabic edition (Dar al-Jeel 1973) Pt 3, 240.
[50] Narrated by Mohammad Al Bukhari, *Sahih Al-Bukhari*, Hadith Number: 2142 (Darussalaam for Publication and Distribution 1999) 13; Muslim ibn al-Hajjaj Nisaboori, *Sihih Muslim*, Hadith Number: 1516 (Darussalaam for Publication and Distribution 1999) 975.
[51] Narrated by Al-Bukhari, Hadith Number: 2033, (n 49).
[52] Narrated by Abu Bakr `Abdi'r-Razzaq Al-San`ani , *Musannaf Abdul Razzaq*, Hadith number 14882, Arabic edition (Dar al-Kitab al-Arabi).
[53] Mentioned in Albukhari in the chapter '*Najash and people who said it should be forbidden*'.
[54] Ali Ibn-Hajer al-Asqalani, *Fat'h Albari fi Sharh Sahih al-Bukhari* (Arabic edition Dar Almarifa), Pt 4,355.

guile in selling, showing the buyer that the item is worth more than its value, and he is willing to buy it.'[55] Ibn dakkek Alaid said: 'no doubt this behaviour is ill-gotten [i.e. *Haram*] because of what is containing of cheating.'[56] That is why scholars unanimously agreed that this is a sin. Ibn Abd albarr said: all scholars agreed that if someone knows and still practises *Najash* surely he is sinner and is disobeying Allah.[57]

Not only this but Ibn Rajab Alhanbali narrated from some scholars a wide meaning of *Najash* in a very solid interpretation suitable here:

> we could explain this Hadith in a wider context, because linguistically *Najash* means exciting something by cunning, resourceful and tricky ways. That is why the hunter is called '*Naajish*' because he does stimulate the prey using tricks. From here the meaning could be: do not cheat each other and do not deal with each other by cheat or tricks, because cheating or tricking has an objective of harming others.[58]

And so from these statements *Najash* does include all sorts of cheats such as hiding and concealing faults, cheating in selling bad quality instead of good, and inequity when dealing with someone who does not know how to do business or bargain.[59]

Second: a man in the city should be commissioner of a man in country side, by saying to him do not sell your goods on your own, I know better than you, I will sell it for you, i.e. he will be his representative in selling his goods. Such dealing is prohibited in Islam.[60]

3.4.2.2 Reasons and Wisdom behind the Forbidding

Voiding harm on citizens, because when the countryside man sells his goods on his own, goods will become cheap for people to buy. Evidence for that is the saying of

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55 Abu al-Walid Albeji, *Almuntaka Sharh Almuwataa* (Arabic edition Dar Alkutub Alelmyah 1999) Pt 3, 467.
56 Ali bin Mohammed al-Amidi, *Al Ahkam Fi Usol Alahkam* (Arabic edition Almaktab Alislami, Beirut) Pt 3, 114
57 Ibn Abd al-Barr Abu Omar Yousef, *Al Tamheed* (Arabic edition Dar Ihya Altrath) Pt 13, 148
58 Abdul Rahman Ibn Rajab, *Gamma Alulum Wa Alhakam* (Arabic edition Dar Ibn Kathir 2008) 30
59 ibid.
60 Mohammed Taqi al-Din Ottoman, *Takmilat Fat'h Almulhim* (Arabic edition Dar Ihya Altrath 2006) Pt 1, 218.

the Prophet (peace be upon him): ‘leave people, get Allah, sustain them through each other.’[61]

Ibn Taymiya (Sheikh Al-Islam) said:

> [I]f a sect of people who used to buy special type of goods (or sell it) made a conspiracy to buy it cheaper than the known price, or sell it more than the known price, this behaviour is more sinful than the interception (see above), more than *Najash*, more than a city man to sell goods of a countryside man. And they may have agreed together to oppress people to push them to buy or sell their goods more than double when people are in need for those goods, if the goods are the ones consumed by normal citizens, its price should not be more than double.[62]

3.4.2.3 Interception of Sellers Out of Market

Intercepting sellers, goods or animals means a merchant going out of the city to intercept the incoming people to buy their goods before reaching the market and knowing the real price.[63] The above evidences indicate clearly the prevention of such dealing.[64]

Reasons for this prevention: to prevent the harm to the incoming dealers, as this interceptor may buy from them much cheaper than the market price. Also preventing harm to people in the market so the interceptor will not gain all the profit only for himself or hold the monopoly of the goods just for himself either to raise the price instantly or hold the goods and hoard them until the price is high. Another reason for this prevention could be considering the situation of the incoming dealer, the Prophet (peace be upon him) said: ‘once the incoming dealer reaches the market he has the option the choose.’[65]

Ibn Taymiya said:

> it is an evil action intercepting goods before reaching the market, the Prophet prohibited it for what it contains of deceiving. As the incoming dealer does not know the real price so he may sell it cheap, and that is

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[61] Muslim ibn al-Hajjaj Nisaboori, *Sihih Muslim*, Hadith Number: 3801 (Darussalaam for Publication and Distribution 1999) 975.
[62] Ahmed Ibn-Taymiya, *Majmu Alfatawi* (Arabic edition Dar al Wafa and Dar Ibn Hazm) Pt 28, 79.
[63] Mohammed Taqi al-Din Ottoman, *Takmilat Fat’h Almulhim* (Arabic edition Dar Ihya Altrath, 2006) Pt 1, 216.
[64] ibid.
[65] Muslim ibn al-Hajjaj Nisaboori, *Sihih Muslim*, Hadith Number: 3798 (Darussalaam for Publication and Distribution 1999) 975.

> why the Prophet gave him the choice, indeed there is no doubt the dealer has the option to choose whenever there is inequity and unfairness.[66]

Ibn Taymiya added, in commenting on the issue of inequity of the one who does not know how to bargain or negotiate, that he has the option to choose, and this is the opinion of Malik and Ahmed and others, as it is not up to the merchants in the market to sell to a negotiator with a price and the one who does not negotiate (who does not know the price) with another. This is what we forbade on the merchants. In a Hadith of the Prophet: inequity of non-negotiator is a usury and it is similar to the interception, as the incoming deals ignore the real price and that is why the Prophet forbade the city man to sell goods of a countryside man in his place and said let people get sustenance through each other.[67]

Ibn Abbas was asked what the Prophet means by forbidding city man to sell in place of the countryside man; he said he should not be a speculator, this is forbidden because it does harm to buyers, when he stands to represent him to sell necessary goods that people need and the countryside man does not know the price this will harm buyers, the Prophet said: 'leave people get sustenance through each other.'[68]

All the above texts indicate clearly that harming, cheating others and gaining profit by manipulation and tricks is ill-gotten. These behaviours are nothing other than cunning and guile, and Islamic law forbad *Najash* and other manipulations because of this.

If the companion of the Prophet (peace be upon him) Abdullah Ibn Abi Awfa said: the one who practises *Najash* is a usury eater and a cheater, and *Najash* is a void deception that is not allowed, then manipulations in stock market and shares no doubt are worse and truly deserve to be forbidden. Especially when it comes to the general meaning of *Najash* where it means: do not cheat each other and do not deal with each other by guile and tricks. As the meaning by cheating and guile is: harming others.[69]

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[66] Ahmed Ibn-Taymiya, *Majmu Alfatawi*, (Arabic edition Dar al Wafa and Dar Ibn Hazm) Pt 28, 74.
[67] ibid 75.
[68] ibid.
[69] Ibn-Hajer al-Asqalani, *Fat'h Albari fi Sharh Sahih al-Bukhari* (Arabic edition Dar Almarifa) Pt 4,356.

Sheikh Al-Islam (Ibn Taymiya) nicely described people who (using collusion) buy goods at cheaper than the normal price and sell them more expensively than the normally known price, he said: 'this behaviour is more sinful than the interception, more than *Najash*, more than a city man to sell goods of a countryside man.'[70]

3.4.3 Ijma (Juristic Consensus) as a Primary Source

Ijma is the agreement of diligent jurists on a specific judgment on their time. Jurists' decisions today are just as valid as the decisions made by jurists around the time of the Prophet's death. The *Ijma* is a strong source of Islamic Law providing jurisprudential provisions and came third after the Qur'an and the Sunnah. The evidence for considering the unanimity in this rank for legislation is the group of verses of Qur'an and hadiths advising to consider the *Ijma* of words of scholars as an argument.[71]

From the Qur'an:

> 'And whoever opposes the Messenger after guidance has become clear to him and follows other than the way of the believers We will link him to what he has chosen for himself and drive him into Hell, the worst destiny.'[72]

And from Hadith the Prophet said, 'My nation will not be unanimated on the misguidance of people'[73] and thus, Hadiths became authoritative. The Hadiths, together with the Qur'anic verses, which demand that followers must respect and obey the decisions of the judicial group, comprehensively justify the provisions in law. The unanimity must have evidences to rely on but if there is evidence stronger than the *Ijma*, it should be considered. An example of an *Ijma* judgment would be the provisions decided regarding a grandfather's inheritance of his grandson's assets. If, for instance, a grandfather outlives his son, then should his grandson die, he (the grandfather) will be entitled to one-sixth of the grandson's assets, which is equal to

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70 Ahmed Ibn-Taymiya, *Majmu Alfatawi* (Arabic edition Dar al Wafa and Dar Ibn Hazm) Pt 28, 79.
71 Mū'il Yūsuf 'Izz al-Dīn, *Islamic Law* (University of Notre Dame Press 2004), 40-41; Alzarqa (n6) 77.
72 Holy Qur'an, Surat Al- Nisa (4), (n 11).
73 Revealed by Abu Dawood from a speech by Abu Malek Alashaa'ry (4253) and Altermey from the Hadeth of Ibn Amr (2167).

the share the father of the deceased would have received should he be alive. This decision was adopted by the companions of the Prophet and so passed into law.[74]

Ijma was attained mainly in the era of Omar as he prevented the companions of the Prophet from leaving the Holy City and thus they were able to easily communicate with each other. Regarding *Ijma* source, the Muslim scholars agreed that cheating and deceiving are forbidden.[75]

3.4.4 Qiyas

Qiyas is to make a judgment on an issue in Islamic law by comparing it to a similar matter where there is a clear adjudication.[76] *Qiyas* comes fourth in the order of importance after the Holy Qur'an, the Sunnah and *Ijma*; most of the time *Qiyas* has a higher impact than unanimity in the jurisprudence judgments because the unanimity issues are limited, also because most Muslim scholars were spread over the Muslim empire (with the difficulty of communication at that time), so they abandoned the dogma of negotiation, and it was difficult for it to be achieved with its complete meaning at the early ages where the circumstances were different from one place to another. Add to that the acceptance of the majority of scholars, and that is not a condition in *Qiyas*.[77]

Each scholar can do '*Qiyas*', which is the most appropriate course of action for a situation that is not accounted for in the Holy Qur'an and the Sunnah, particularly situations where no unanimity has been reached.[78]

The texts of the Holy Qur'an and the Sunnah are limited and finite; whereas the number of possible issues are infinite and unpredictable. The best courses of action in dealing with new issues arising in Islamic law are therefore gauged by scholars'

[74] Alzarqa (n6)78.
[75] Ibn-Hajer al-Asqalani, *Fat'h Albari fi Sharh Sahih al-Bukhari* (Arabic edition Dar Almarifa) Pt 4,447.
[76] Muhammad bin Aeesa, *Al-Gam'a Al- Sahih; Sonan Al-Tremady* (Dar Al-Faker 1980) Pt 3,315; Abdur Rahman I. Doi, Abdassamad Clarke, *Shari'a: The Islamic Law* (Ta Ha Publishers 2008) 112.
[77] Majid (n2) 7.
[78] Alzarqa (n6)79.

own judgment.[79] The gauging is the thrust of jurisprudence resources in the secondary rules of the new issues.

Omar's guidance to Abu Mosa Al-Ashary in his letter on the basis of judgment and its optimization said: 'Problems, which pain the heart and for which no guidance exists, either in the Qur'an or the Sunnah, must be dealt with using your own judgment on what Allah's will is.'[80]

3.5 Subsequent Sources of Islamic Law: Approbation

There are yet more additional rules upon which jurisprudence is based apart from the aforementioned four sources. The three 'subordinate' sources, *Istahsan* (Reprobation), Reform, and Reclaiming and Tradition, will be described in this chapter.

3.5.1 The First Source of Guidance

Istahsan is the abstention from ruling the same judgment in two equally weighted issues, if there is a stronger reason, which deserves that abstention. This line of thought can be attributed to Imam Abu Al-Hassan Al-Karkhy, one of the leaders of the Hanafi School. This means that approbation is abstention using gauging in equally weighted issues. So approbation is separating the issues and it is the opposite of gauging.[81]

The approbation is based on the reason; in Islamic Law we can distinguish two types of approbation: 1) the gauging re-approbation, 2) the re-approbation based on necessity.[82]

3.5.2 Sadd al-dhara'i' (Blocking the means)

Sadd al-dhara'i' means the tools or justifications to attain a goal. In many cases, legally prohibited acts or behaviours, are prohibited not in themselves, but because

[79] Shahr Alsatany, *Almelal and Alnahl* (Arabic edition Dar Alkutub Alilmyah 1992).
[80] This book was sent by Omar to Abu Musa after his enthronement and is considered by scientists to be a constitution on judgment and *Feqh*.
[81] Abdul Aziz Al-Bukhari, *Kashf Alasrar*, Arabic edition (Arab Book House 2008) Pt 3,4.
[82] Alzarqa (n6)87–88.

they are leading to something that is prohibited legitimately even if it is not intended to do so, or to be an excuse used intentionally to cling to this prohibited thing, nowadays so-called fraud. So it is prevented legitimately that any way or mean that might lead to legitimacy caveats intentionally or unintentionally. And this origin called in jurists and fundamentalists' convention is the principle of block pretexts; it is a wide section connected to legislation policy so it is considered as a branch of reclamation.[83] In addition, the Hanbli school is most clearly oriented to the public interest.

An example of this can be found in the Holy Qur'an, where believers are commanded not to insult the idols worshipped by idolaters, so that anger is not provoked towards believers of God, causing the idolaters to insult God in their ignorance. The Qur'an says: 'Revile not those unto whom they pray beside Allah lest they wrongfully revile Allah through ignorance.'[84]

3.5.3 Al-Masalah Al-Morslah

Under Islamic law there are several different sources of law - *Al-Masalah Al-Morslah* being one of them. In Islamic law, *Al-Masalah Al-Morslah* means:[85] This is a significant and supportive source for dealing with new matters and is considered to be the most valuable source that qualifies the legislator in an Islamic state to keep pace with new environments. In addition, the Maliki school is most clearly oriented to the public interest. In the application of this source of law, the following conditions must be satisfied:[86]

(a) The interest must be real and not just imaginary, that is to say, the legislation in question must either engender happiness or prevent unhappiness.

(b) It must be a matter of public and not personal interest.

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[83] Alzarqa (n6)107.

[84] Holy Qur'an, Surat Al- Al-An'am (6), Ayah 108, (King Fahd Complex for the Printing of the Holy Qur'an).

[85] Doi, (n **Error! Bookmark not defined.**) 8; Abdulalwahhab khlaf, *Eulim 'Usul Alfaqqih* (Dar alzzuhra' 1995); Mohammed aljayzani, Maealim 'Usul Alfaqqih (Dar ibn aljuzi 1998).

[86] Mohammed Ali Al-Bar and Hassan Chamsi-Pasha, *Contemporary Bioethics* (Springer 2015) 67-69; Al-Homady (n **Error! Bookmark not defined.**) 361; Mustafa Alzarqa, *Almadkhal Al-Fighi Alaam* (Arabic edition Dar Al-Qalm Publisher, Damascus) 100-106; Mohammed al'ashqur ,*Alwadih Fi 'Usul Alfaqqih lLilmubtadiiyn* (Dar alnnafayis 1996).

(c) Legislation must not conflict with rules or principles provided in the Qur'an, the Sunnah or *Ijma*.

3.5.4 Subordination Sources: Tradition

The word '*Urf*' in Arabic is derived from '*Ma-rifa*'. It has been used to describe the known issues which people accept as common sense and adopt to be part of their life. God says, 'Take what is given freely[87], instruct people to follow '*Urf*' and turn away from the ignorant.'[88]

But in idiosyncratic terminology, tradition means 'people's habit in talking or doing.'[89] It is understood from this definition that traditions cannot exist unless they are agreed with and followed by people residing in the place where the traditions belong. An example of this would be families living in the Middle East nowadays, where the tradition suggests paying two-thirds of a dowry in advance of a wedding and the remaining third after death or divorce. The perpetuation of this tradition is considered a 'habit' of the public, accounting for this terminology. Jurists predominantly view the terms 'habits' and 'customs' as interchangeable. Traditions are also observed by large numbers of people, distinguishing them from individual behaviours.[90]

3.6 The value of the different Schools in Islamic Law

Some ignorant people think that basing law on a diverse range of opinions is detrimental because of lack of foresight to see the benefits. They may even go as far as thinking that these differences are discrepancies in the legislation sources, contradicting each other to get rid of this corrupted illusion we call the heinous doctrinal differences, which have only disadvantages is the differences in the beliefs; while the jurisprudential differences in the civil practice provisions is the feats and ammunitions, because the wider the legislation resources the more widely they can be made and useful and effective.[91]

[87] Originally, the term 'freely' in Qur'anic verses referred to 'the intention to take something',
[88] Holy Qur'an, Surat Al-A'raf (7), Ayah 199, (n 11).
[89] This definition appeared many times in the works of numerous scientists mentioned by Ibn Abden. See: Mohammed Ibn Abden, *Majmo Alrsail* (Arabic edition Dar Alam Alkutub Alelmyah, 2005).
[90] Alzarqa (n6)141–142.
[91] Ali Naif, *Dlalat Ashrat Horof* (Arabic edition Dar Albashair, 2008) 1–5

Apparent difference in opinions and judgments within the law can be attributed to the fact that there are often many different routes to resolving a single issue. One can select the guidance that is most appropriate for a particular situation. An analogy could be an individual who is tired of sitting in a certain type of chair, and so goes and sits in another more comfortable chair of a different type. Or like a city having many pharmacies, if a medicine is not available in one, we can merely go to another pharmacy. Likewise, there are many different sources, which may be tapped in to solve a given problem.[92] El Siouty said:

Haron El Rashid asked me to attach *Al-Muwatta* [book of Malik] on the wall of *Kaaba* [the holy room], and impose on people to follow it. Malek replied, 'O'you Caliph, bear in mind that the companions of the Prophet themselves differed in the details, and they spreads in the countries, each one of them due to himself is right', and it seems that El Rashid repeated this request again; then Malek Said 'O'you Caliph, the differences in the scholars' opinions are a mercy from the Allah for this nation, as each one follows what is right due to him, and every one of them is right, and all they seek is blessing of Allah.[93]

Abu Bakr bin El Aribi (follower of Maleki School) said of the Qur'an verse that says 'And hold tight to the cable of Allah, all of you together, and do not separate', where 'Do not separate' refers to the separation or divergence of beliefs among followers. It asks followers to resist this and 'not look for others' faults', where 'faults' refer to differences in the branches of jurisprudence. Regardless of the school of jurisprudence that different people follow, as long as all 'hold the cable of Allah' then all schools are equally valid. The only prohibited schools are those which encourage sedition or the dispersion of followers; while the differences in the branches are virtues of legislation, as the Prophet Muhammad (God's peace be upon him) said, 'If a judge tried and got it right so he will get twice rewards, and if he gets it wrong he will get one reward for trying.'[94]

Imam Abu- Ishaq El Shatbi said, 'I will not like it if the companions of the Prophet did not differ in thought, since if things had to be one way only, society would be run

[92] Alzarqa (n6)269–270.
[93] Jalal Aldeen El siouty, *Tazyin Alm malek Fe Manaqb Alemam Malek* (Arabic edition Almatbah Alkhairah) 46.
[94] Abu Bakr bin El Aribi, *Alahkam Alsoghra* (Arabic edition Dar Alkutub Alelmyah 2006).

very strictly. They are all scholars and are examples to be followed and if a man takes their advice he will live in opulence.'[95]

This means that people were permitted to use their discretion and offer differing opinions on a matter; otherwise, anyone who applied discretion in a rigid system would suffer hardship and prejudice. God's allowance for differing opinions made for a society which could draw from a broad and diverse range of judgments when trying to solve a problem. This was an opportunity for all of them to be included in Gods mercy when easing the life of others.[96]

Mohammad Abou Zahra commented on this as follows:

> The difference in opinion among the companions of the Prophet Muhammad (peace be upon him) across subdivisions was a result of their allegiance to him. That is why there were neither jurisprudence disputes nor sectarianism, just the quest for truth and righteousness, regardless of its source. Differences were expressed through brainstorming, deriving judgments from the Qur'an and extracting general legislation in case it was not written. The difference in views across the different schools is nothing but the fruit of creative minds searching for solutions and ways to manage their affairs through Shura consultation and the exchanging of opinions on interpretations of the Qur'an and the Sunnah.[97]

As long as Islamic jurists have different perspectives and understandings, differences in opinion are a necessity. Although different opinions and interpretations may seemingly contradict each other, none may contradict the source of legislation itself and so each opinion can be considered equally valid. The texts are thus flexible and may be interpreted in any way which is beneficial to solving the particular issue at hand.

The abundance of possible interpretations of the main texts when legislating beside the divergence in gauging ways will make differences between scholars on obligation, but this will make these differences highly valuable.[98]

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[95] Abu-Ishaq El Shatbi, *Alitisam* (Arabic edition Dar Altawheed2008) Pt 3, 11.
[96] ibid.
[97] Mohammad Abou Zahra, *Al Mulackia wa Nathariat Al Ackd* (Arabic edition Dar Alfuker Alarabia 1996) 19–20.
[98] This appears in the introduction of *Rafae Almalam Ean Al'ayimmat Al'aelam*, which briefly researches the differences between improvisations in judgment, the reasons for this improvisation and its necessity.

3.7 *Ijtihad* and *Ikhtilaf*

The most important source in Islam is the Qur'an. The Qur'an is regarded as the fundamental book of law, containing significant verses, similar to previous scriptures such as the Torah. A careful study of the Qur'an shows many legal verses to be general in nature, rather than specific.[99] This in turn leaves the meaning ambiguous and requires the jurist to diligently look into the secondary source in Islam, i.e. the Sunnah. The Sunnah, as mentioned above, can generally be summarized as the words, actions and approval of the Prophet Muhammad, as recorded by the companions around him. For instance, the verse in the Qur'an that declares 'God has permitted trade and forbidden *riba*'[100] does not state which contracts are valid and which invalid. This, therefore, must be determined through study of other sources.

The great jurist of Islam, Al-Shafi'i, established the Sunnah as an authoritative source of Islamic law. However, differences were created due to the Sunnah being carried through the oral tradition in the earlier centuries, which, in turn, led to conflicting statements. Consequently, the early century jurists of Islam disagreed on many matters and developed varying methodological principles. Al-Shafi'I, for instance, argued that if '*Ijmaa*' (consensus) were present, this in turn would elevate the ruling to a canonical level. However, several jurists, who did not agree with the notion of local consensus being deemed authoritative, rejected this.[101]

In the absence of definitive Qur'anic verses or Prophetic the Sunnah to address a particular issue, jurists resorted to the process of inference or analogy. The term *Ijtihad*[102] is used to describe the overall process of juristic striving in order to derive rulings from the Qur'an and the Sunnah. Al-Shafi'i advocated a strict adherence to analogical reasoning and rejected other principles of law extraction, such as *Istihsan*[103] (juristic preference of rulings based on the perceived benefit) and *Urf*[104]

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[99] L. Ali Khan and Hisham M Ramadan, *Contemporary Ijtihad* (Edinburgh University Press 2011) 14; Wael B Hallaq, *The Origins And Evolution Of Islamic Law* (Cambridge University Press 2005) 130; P. J Bearman, Rudolph Peters and Frank E Vogel, *The Islamic School of Law* (Islamic Legal Studies Program, Harvard Law School 2005) 139–141.

[100] Holy Qur'an, Surat Al-baqara (2) Ayah 275, (n 11).

[101] Mohammed Al-Shäfi`i, *Al-Risälah* (Arabic edition 1983) 52-53.

[102] '*Ijtihad*' (Arabic) is the term used to designate innovations in Islam and Sha'aria (Muslim law). The word comes from 'struggle': JM Cowan (ed), *Hans Wehr Dictionary of Modern Written Arabic* (3rd edition, Spoken Language Services, Inc.1976) 143.

[103] '*Istihsan*' (juristic preference) literally means to deem something preferable. In its juristic sense, *Istihsan* is a method of exercising personal opinion (ray) in order to avoid any rigidity and unfairness

(customary practices). However, in classical jurisprudence, we can also find the concept of benefit being utilized by jurists when giving economic rulings.

Generally, jurists put forward four criteria for rationalistic or benefit-based analysis: (1) making apparent benefit permissible; (2) forbidding clear harm and destruction; (3) providing more legal freedom under the fundamental foundations and (4) taking the environment of society at the present time as a factor.

In addition, a framework was laid down to address the issue of how these principles of benefit can be applied. The four schools in Sunni jurisprudence stayed away from overruling explicit and specific textual rulings; some jurists allowed the restriction of general rulings, which could not be applied due to benefit analysis.[105] Furthermore, benefit analysis was also permissible regarding doctrinal texts that were deemed to be weak in authenticity or ambiguous in meaning.

The foremost scholars of *Madhahib* schools of thought, such as the Hanafis, depended on reasoning and analogy because of the lack of the Sunnah literature present around individuals such as Abu-Hanifa. On the other hand, Maliki's, Shafi'is and the Hanbalis were more conservative in relying strictly upon the text and rejected influences from outside the sources. The Maliki jurists rejected apparent analogies if their rulings contradicted customary practices, preventing apparent benefits or leading to significant harm. Essentially, each and every school of thought advocated that if an opinion was found that was stronger and more in accordance with the Sunnah, then one should abandon other opinions and adhere to the new one.

Some scholars in the twentieth century, including the great Azhari jurist Abdul Wahhab. He went so far as to say that when benefit analysis and other legal proof were contradictory, 'maximising net benefit is the objective of the law for which

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that might result from literal application of law. *Istihsan* as a concept is close to equity in Western law. However, equity is based on natural law whereas *Istihsan* is essentially based on divine law: Kamali, *Mohammad Hashim Principles of Islamic Jurisprudence* (Islamic Text Society Cambridge 1991).

[104] '*Urf*' العرف is an Arabic term, which means general opinion or custom in a community. This is a very important term in *fiqh* as many of the rulings (*fatwas*) issued by a mujtahid on different issues (*masail*) are based on *Urf*. On the other hand, there are also many rulings in *fiqh*, which are not based on *Urf*: H Patrick Glenn, *Legal Traditions of the World* (Oxford University Press 2007) 201.

[105] Ignaz Goldziher, *Introduction to Islamic Theology and Law* (A and R Hamori trs, Princeton University Press 1981).

rulings were established' and that 'objectives should always have priority over means'.[106]

In the Ottoman codified law of the nineteenth century, *MajAllah al-akhkam al-'adiliyya*, we can find five rules that directly contradicted the canonical texts but were none the less supported by jurists on the basis of reducing hardship by modifying customary practices.[107] Some have even gone so far to say that customary practices are similar to canonical rulings. In the article 39 of the Ottoman codification, it was stated that juristic rulings must keep up with the times.

Traditionally, Islamic jurisprudence is divided into eight periods. The first period ended with the death of the Prophet Muhammad in 632 CE, while the companions of the Prophet interpreting. The Islamic rulings or legislations from the Qur'an and the Sunnah marked the second period, which lasted until 670 CE. The third period gave rise to the two camps of jurists: *AhlRai* (people of opinion) and *Ahl al Hadith* (people of tradition), which later paved the way to establishing the eight most significant schools of Islamic jurisprudence.[108] This was the golden age of classical Islamic jurisprudence, lasting from the beginning of the second century to the middle of the fourth century AH.

From the mid-fourth century, jurists limited themselves to deriving laws within the framework of their own juristic schools. This lasted until the middle of the seventh century AH. The fall of Baghdad to the Tartars in 1300 CE marked the beginning of the dark age of Islamic jurisprudence. When the Ottomans codified *HanafiFiqh* in the form of the *MajAllah* in 1876 CE, this marked the renaissance of Islamic jurisprudence. From the late nineteenth century onwards, revivalist and reformist movements were active, led by figures such as Muhammad Abdu and Jamal Uddin al Afghani, whose aims were to reinterpret classical rulings for modern times. Finally, in the most recent period, Islamist trends predicated goals of establishing Islamic states and Islamic economics. As a result of the Islamist movement, classical

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[106] Islam and Economics, 'Al-`Awwa on the Need to Reinvestigate Legal Objectives' (Maqasid) <elgamal.blogspot.com/2007/04/al-awwa-on-need-to-reinvestigate.html> accessed 27 November 2015

[107] Global Islamic Finance, 'MajAllah al-akhkam al-'adiliyya' <www.global-islamic-finance.com/2009/07/al-majAllah-al-ahkam-al-adaliyyah.html> accessed 27 November 2015.

[108] Alzarqa (n6)199–201.

jurisprudence is read uncritically, and this has given rise to inefficiency in Islamic financial industries.[109]

Muslim societies should go beyond literal adherence to classical jurisprudence. What is needed is a revival of the substance of classical jurisprudence in the modern context. Contemporary jurists, such as Imam Abdul-Aziz Ibn Baz, Imam Muhammad al-Albani and Imam Muhammad ibn al Uthaymeen, have made progress in this direction.[110] Traditionally in the Islamic juristic structure, the unconstrained and independent *Mujtahid*, generally limited to the great Imams of the golden age, are deemed qualified to lay down principles in order to derive laws from the canonical texts.

On the other hand, the other category of jurists (who are unconstrained but dependent) have generally been required to rely, in varying degrees, on the framework established by the former category of jurists. A key reason why the title of unconstrained/independent *Mujtahid* has only been attributed to the great imams of the golden era is the very high level of knowledge of Islamic sciences, Arabic language, syntax, culture and context that is required. However, scholars such as al-saa'di have sought for a renewed *Ijtihad*, including the framework principles of law derivation facilitated by collected *Ijtihad*. This has been argued on the basis that groups of jurists may attain sufficient expertise and ability through collaboration. This call was first made shortly after the fall of the Ottoman Empire, in 1924.[111]

In order to cater for this collective *Ijtihad*, appropriate forums needed to be provided and, to this end, Muslim countries started to establish both national and international juristic councils. At the forefront of these councils was the Institute of Islamic Research at Al-Azhar University in Cairo, established in 1961, and the Islamic Jurisprudence Council of the Muslim World League, established in Mecca in 1979. It was within this context and framework that 'Islamic finance' was born during the 1970s.[112]

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[109] ibid.
[110] Islamic Finance: 'A History' <www.assaif.org/content/download/.../Islamic%20Finance%20History.pdf> accessed 27 November 2015.
[111] Mohammed Mari, *Ijtihad Fi Alshari Alislamih* (Arabic edition Imam Mohammed University 1983).
[112] El-Gamal, *Islamic Finance: Law, Economic, and Practice* (Cambridge University Press 2009) 53.

More recently, institutions such as the Accounting and Auditing Organization for Islamic financial institutions sponsored by banks, have put in place their own Islamic law boards for Islamic finance.[113] The institution of *fatwa* (juristic responses to questions) relies upon these Shariah boards in matters of Islamic finance; Islamic finance practitioners present most of the questions considered by these juristic boards.

The Islamic financial institutions have gradually moved closer towards conventional non-Islamic financial practices. The current generation of Muslims have already become accustomed to hearing and reading in religious books that *Murabaha* is an accepted Islamic form of finance, making the work of future jurists in developing jurisprudence that is efficient, Islamically compliant and much more difficult.[114]

3.8 Islamic Objective

3.8.1 Good Faith

In Islam, Prophet Mohammed (peace be upon him) encouraged Muslims to gain *Halal* (lawful ownership of goods) and warned us against *Haram* (forbiden ownership).[115] One of the Hadith narrated by Abu Huraira quoted the Prophet (peace be upon him) saying:

> Allah is good and accepts only that which is good, Allah has ordered the faithful [*Al-mumineen*] same order as the one he made to messengers by saying, "O you messengers; eat of good things and do right, indeed I know what you do"[116] and said: "O you believers, eat good things, which we provided to you"[117] He then mentioned a case of a man who travels long journeys dishevelled and dusty raising his hands to Allah asking: O my lord, O may lord, whereas his food and clothing are all Haram [owned unlawfully], how can he get a replay.'[118]

One way of the *Halal* gaining is commerce, and of course Allah almighty clarified in his Book as well as His messenger made clear all legislations of trading, buying and

[113] See official page for: Accounting and Auditing Organization for Islamic Financial Institutions <http://www.aaoifi.com/> accessed 27 November 2015.
[114] Financial Services Authority, 'Islamic Finance in the UK: Regulation and Challenges' <www.fsa.gov.uk/pubs/other/islamic_finance.pdf> accessed 27 November 2015.
[115] Mohammed ibn Alhasan, *Ketab Alkasb* (Arabi edition Dar Almatboat Alislamiah 2005).
[116] Holy Qur'an, Surat Almuminoon (23) Ayah 51, (n 11).
[117] Holy Qur'an, Surat Albaqarah (2) Ayah 172, (n 11).
[118] Narrated by Albukhari (Hadith number 5203), (n 49); Muslim (Hadith number 1407), (n 49).

selling, renting, the warrants, mortgage and so on, and established for such activities some values that all Muslims must follow, such as acting with good manners in both buying or selling, so trustworthiness and honesty are general characters of a Muslim, ‘O you believers, fear Allah and stand with the truthful’;[119] ‘Allah orders you all to hand back what people saved with you [trusts] to their owners’[120], but most importantly these characters are required in financial dealings; the Prophet (peace be upon him) said: ‘the honest and trustworthy trader is with the messengers and martyrs.’[121] He also said: ‘The seller and the buyer have the right to keep or return goods as long as they have not parted or till they part; and if both the parties spoke the truth and described the defects and qualities [of the goods], then they would be blessed in their transaction, and if they told lies or hid something, then the blessings of their transaction would be lost.’[122]

The Honesty is required with Muslims and non-Muslims at the same level, and that is why when Muslims were honest in their trading and all other activities, this left a huge and positive impact on non-Muslims and led many nations to embrace Islam. Trustworthiness is a good requirement that any Muslim should hold to; the Prophet (peace be upon him) said: ‘Return The Trust To Those Who Entrusted You, And Do Not Betray Even The One Who Broke His Promise To You.’[123] Additionally, one of the Muslim’s good values is forgiveness and indulgence in trading and all other activities, and that is why the Prophet (peace be upon him) said: ‘May Allah have mercy on the one who is [*samaha*] easy-going and generous while engaged in buying, selling and demanding his rights.’[124]

It is important to avoid denial and warn people against cheating and deceptions in business, knowing that Islam forbids all of that no matter in what form it comes. In trading and any other human dealings, the Muslim is always required to be honest in all his life, and the good advice and clearness is the best reward as the Prophet

[119] Holy Qur’an, Surat at-Taubah (9) Ayah 119, (n 11).
[120] Holy Qur’an, Surat Al-Nisa (4) Ayah 58, (n 11).
[121] Narrated by At-tirmidhi (Hadith number 1210), (n 12). After this Hadith Imam Altirmidhi said this Hadith is Hassan Saheeh (acceptable but not as high as Saheeh).
[122] Narrated by Albukhari (Hadith number 293), (n 49).
[123] Narrated by Abu Dawood (Hadith number 3535), (n 12); Al-tirmidhi, (Hadith number 1264), (n 12). After this Hadith Imam Altirmidhi said this Hadith is Hassan Qhareeb. (acceptable but not as high as Saheeh); Shaikh Al-Albani said this Hadith is Saheeh. See: Muhammad Nasir al-Din al-Albani, *Irwa al-Ghalil fi Takhrij Ahadith Manar al-Sabil* (Al-Maktab al Islami, Beirut, 1979) Pt 3, 283.
[124] Narrated by Albukhari (Hadith number 2076), (n 49).

(peace be upon him) said: 'The *Deen* [religion] is *naseehah* [advice/sincerity]'[125] and he further said:

Both parties in a business transaction have a right to annul it so long as they have not separated; and if they tell the truth and make everything clear to each other (i.e., the seller and the buyer speak the truth, the seller with regard to what is purchased, and the buyer with regard to the money) they will be blessed in their transaction, but if they conceal anything and lie, the blessing on their transaction will be eliminated.[126]

Moreover, one day the Prophet happened to pass by a heap of corn. He thrust his hand in that [heap] and his fingers felt wetness. He said to the owner of that heap of corn, "What is this?" He replied: "O Messenger of Allah! These have been drenched by rainfall." He remarked, "Why did you not place this (the drenched part of the heap) over the corn so that people might see it? He who deceives is not of us.'[127]

Even the effect on food can easily disappear still the Prophet denied cheating in it; and so what about more serious issues? So the true believers impose honesty, faithfulness and good advice. In a true Hadith, the Prophet (peace be upon him) said: 'None of you [truly] believes until he loves for his brother what he loves for himself.'[128] So any faithful trader needs to clarify to buyers any defect in goods, if it has any. As the prophet (peace be upon him) said: 'A Muslim is a brother of Muslim, and it is forbidden for him to hide any defect in goods he is selling to him.' If you want to sell a car or food such as fruits etc, you must show any damage in it otherwise any blessing in this trade will be destroyed and will become like a loss. Unfortunately, we do see some merchants putting good pieces of fruits on top of bad or small ones, and of course this is cheating and it is *Haram*.

One of the biggest sins in business is lying while swearing to convince the buyer that goods are in good conditions or that he bought it for such and such a price. The Prophet (peace be upon him) said: 'The swearing [by the seller] may persuade the buyer to purchase the goods but that will be deprived of Allah's blessing.'[129] Another type of cheating is playing with weights and volumes; Allah in the Holy Qur'an

[125] Narrated by Muslim (Hadith number 4944), (n 49).
[126] Narrated by Albukhari (Hadith number 2079), (n 49).
[127] Narrated by Muslim (Hadith number 2123), (n 49).
[128] Narrated by Muslim (Hadith number 47), (n 49).
[129] Narrated by Albukhari (Hadith number 2087), (n 49).

warned us from the same by saying, 'Give just weight, and full measure, and do not diminish the goods of people. Do not corrupt the land after it has been set right, that is best for you, if you are believers.'[130] In a Hadith narrated by Ibn Omar the Prophet (peace be upon him) said:

O Muhajirun, there are five things with which you will be tested, and I seek refuge with Allah lest you live to see them: Immorality never appears among a people to such an extent that they commit it openly, but plagues and diseases that were never known among the predecessors will spread among them. They do not cheat in weights and measures but they will be stricken with famine, severe calamity and the oppression of their rulers. They do not withhold the *Zakah* of their wealth, but rain will be withheld from the sky, and were it not for the animals, no rain would fall on them. They do not break their covenant with Allah and His Messenger, but Allah will enable their enemies to overpower them and take some of what is in their hands. Unless their leaders rule according to the Book of Allah and seek all good from that which Allah has revealed, Allah will cause them to fight one another.[131]

3.8.2 The Necessity of Knowing the Rules of Selling and Buying

Anyone who wants to earn from trading must know what will make his deals right or fake, to make his dealings correct and his behaviour honestly. Caliph Omar used to go around the market and stick merchants by his stick (*Addirrah*) and ordered: 'no one should sell in our market unless with knowledge otherwise he will eat usury whether he wants it or not.'[132]

Unfortunately many Muslim people neglected dealing with knowledge not caring about eating *Haram* (forbidden wealth) as long as they gain more and more. Of course, this is a big genuine mistake, which anyone willing to trade should avoid by knowing what is allowed and what is forbidden, so he will have his wealth blessed and be far away from doubts. The Prophet (peace be upon him) said: 'That which is

[130] Holy Qur'an, Surat Al-A'raf (7), Ayah 85, (n 11).
[131] Narrated by Ibn-Majah, Hadith number: 4019, (Darussalaam for Publication and Distribution, 1999). Shaykh al-Albaani said this Hadith is Saheh. See: Muhammad Nasir al-Din al-Albani, Silsilat al-Ahadith al-Sahiha, (Maktabat al- Maarif 1996) Pt 1, 176.
[132] Narrated by Al-Tirmidhi (Hadith number 487), (n 12). After this Hadith Imam Altirmidhi said this Hadith is Hassan Saheeh. Also Shaykh al-Albaani said this Hadith is Hassan (Saheh Al-Tirmidhi); Anas Abdulhadi, `*Darorat Tawih Altujar*`(1997) 3 Journal of Islamic economic centre, Alazhar University, 25.1

lawful is clear and that which is unlawful is clear, and between the two of them are doubtful matters about which many people do not know. Thus he who avoids doubtful matters clears himself in regard to his religion and his honour, but he who falls into doubtful matters [eventually] falls into that which is unlawful, like the shepherd who pastures around a sanctuary, all but grazing therein. Truly every king has a sanctuary, and truly Allah's sanctuary is His prohibitions. Truly in the body there is a morsel of flesh, which, if it be whole, all the body is whole, and which, if it is diseased, all of [the body] is diseased. Truly, it is the heart.'[133]

3.9 Market Manipulation in Islamic Law

The word of manipulation has a specific Arabic meaning. Stock market manipulation is more than playing around; it is a premeditated crime with bad intention, in other words it is deviant behaviour in the stock market. However, in Islamic finance, the definitions, which are closely related to market manipulation, shall now be outlined.

1) Endangerment (*Al-Taqreer*):

(i) The exposure of person(s) to danger.[134]
(ii) Giving an exaggerated or deceptive account of an item's qualities, often portraying the item as being more valuable than it actually is, misleading another party into purchasing the item under false pretences.[135]
(iii) Encouraging or tempting parties by deception to perform some action.[136]

Endangering in dairy cattle by not milking them for long time before selling, in order to delude the buyer with the quantity of their milk is another example.[137] It should be noted that there is a difference between endangerment and danger, where danger is defined as:

1) Something which has an unknown consequence.[138]

[133] Narrated by Albukhari , (Hadith number 2087), (n 49).
[134] Jamaluddin Muhammad Ibn Manẓūr, *Lisān al-ʿArab* (Dar Sadir 1997); Mahammed El Razi, *Mokhtar El Sahah* (Maktabt 1986) 471–472.
[135] 'Provisions of Legitimate Transactions' (Dar Sadir1997) 377–380; Nazih Hamada, *Mujam al-Mustalahat al- Maliyah wa al-Iqtisadiyah fi Lughah al-Fuqaha* (Dar al-Qalam 2008) 119.
[136] Mohammed El Zarqa, *Al Madkhal Alfiqhi Alaam*, (Dar Al-Qalam1998) Pt 1, 379.
[137] Mohammed El Zarqa, *Al Madkhal Alfiqhi Alaam* (Dar Al-Qalam1998) Pt 1, 463-464.
[138] ibid.

2) What was unknown between two allowances and the best of them is the most fairly one.[139]

There is, however, some similarity between danger and ignorance, and these concepts were differentiated by El Qrafi, who said:

> The danger is the unknown whether it will happen or not, like selling the birds before caching it or selling fish in the water. While what is known has happened and was ignorance about its character, like selling anything he has in his bag, but he does not know what it is. Danger and unknown, every one of them is more general than other on one side and more specific on another side.[140]

There is a distinct difference between danger and endangerment, though danger refers to unknown consequences, while endangerment refers to sayings or actions, which trick someone; hence, danger involves risk and endangerment involves trickery, which leads to risk. From the definition of endangerment at the start of this section, and its closely related terms, it can be reasonably deduced that endangerment is one form of 'market manipulation' since the manipulation of others is typically done through trickery, fraud, deceit and illusion.

About fraud, Ibn Qudama says: 'If one, with the intention of concealing a defect, hides it from the buyer instead of declaring it or covers it to delude the buyer into thinking that there is no defect, then they have committed fraud, meaning an injustice towards the buyer.'[141] And it has been said that 'fraud can be committed in two ways: the first way is by hiding a defect and the other is by adding makeup to raise the price. From previous definitions it can be deduced that fraud is another form of market manipulation.'[142]

Similarly, trickery is when a man pursues illegal ways to achieve his purpose in such a manner that nobody detects his deceit without some semblance of intelligence and insight.[143] And this thing does exist in manipulation by showing some things

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[139] Ali El Mwardi, *El-Hawi Alkabeer*, (Dar Alkutub Alelmyah 1994) Pt 5, 325.
[140] Ahmed Alsanhaji El Qrafi, *Anwar Albroq Fee Anwa Alforoq "El Froq"* (Dar Alsalam 2001) Pt 3,365.
[141] Mohammed Ibn Qudama Al-Maqdissi, *El Moghani* (Dar Alam Alkutub 1997) Pt 6, 234.
[142] Mohammed El Baali, *Almuttala Ala Aboab Alfiqh* (Almaktab Alislami 1988) Pt 11,236.
[143] Ibn Qayyim al-Jawziyyah, *I'laam ul Muwaqqi'een 'an Rabb il 'Aalameen* (Dar Ibn Aljawziyy, 2008) Pt 3,309.

different from what is hiding in order to reach a specific purpose.[144] A gyp utilizes both trickery and endangerment to induce an individual to buy a commodity, resulting in the selling party profiting from the buyer. A gyp is not just restricted to this definition and can also involve danger (where the commodity was sold by dishonest advertisement) and, thus, the gyp may be considered a specialist form of manipulation.[145] So the manipulator is one who solicits and stimulates other traders to make them act thinking that they can make profit, whereas in reality they will lose. Should this be considered as just a play, or is it a sort of cheating and betraying?

Theoretically we need to differentiate between stock exchange traders, investors, speculators and manipulators, knowing that the investor is the one who owns the currency as an asset to gain profit from it, like a production asset generating profit time passes. Whereas the speculator is the one who uses the currency as a commodity, wishing its price to increase to get rid of it and make profit, he buys it with the intention to resell it and make profit.

Based on this we can guess that the currency might remain in the possession of the investor much longer than in the possession of the speculator. That is to say, both investor and speculator are supposed to have enough reliable information about the currency they are dealing with. Like a merchant who is keen to choose his commodities, we can say the speculator is truly a merchant in the right meaning of the world, the market is his shop and the stock his commodities. That is why if he does not rely on genuine information and plays just by chance then he is merely gambling. Whereas the manipulator does not rely for his decisions on information gained nor on chance, but he creates the circumstances by giving a false impression to stimulate other traders and let them act according to wrong information, then he jumps on the market buying or selling, making profit without care for others who lose, not only that but he pushes them to lose heavily so he can make a bigger profit. Investors in the stock exchange are very few, but the expert speculators are more, the

[144] Al-Maqdissi (n154) Pt 6, 304.
[145] ibid.

gamblers are even more, whereas manipulators as a matter of number they are very few, but they have a high influence in stock market.[146]

3.9.1 Financial Market in Islam

Islamic Law has approved all sorts of markets, observing their necessity for individuals and societies who cannot dispense with them, stating the need to respect all rules and regulations in any market. Islamic law accords much importance to markets, creating rules and regulations to prevent violations and harmful behaviours such as cheating, holding monopoly, fraud, stimulation, etc. It made one of the priorities of a ruler to control markets, to see what happens in them and punish any trouble makers.[147]

When the Prophet (peace be upon him) migrated to Medina he noticed that the market was dominated by Jews, who were abusing the Arab people living there, so one of the first decisions he made was to create a market for the Muslim people in Medina to free them from being abused. But he did not create this market without providing guidance, he set out rules and one day announced publicly: 'Who cheats is not one of us'; cheating was seen as a big sin that would remove cheater from of the Muslim community. He also appointed some of his great companions to control and check regularly the attitudes and behaviours of people in the market.

His successors did the same; we can find many stories of the second Khalifa (Omar ibn Alkhattab) who was very stringent with manipulators and monopolists, and he was very interested in establishing a stable market, obliging merchants not to increase nor decrease the price of some goods, although the decrease would be good for customers but still Omar refused this because it might lead to disputes between the merchants and might affect the stability of the whole market.[148]

Islamic law paid great attention to business and markets and protecting them from any sort of misconducts and manipulations. The scholar Yahia ibn Omar said: 'any

[146] Obaidullah Ibn Battah Al-Akbaree, *Prohibition of Fraud* (Ar-Risaalah Company 1996) 112-122.
[147] Mubarak Alsulyman, *Ahkam Altaamul Fe Alaswaq Almalyah* (Knoz Ishbylah 2005) Pt 1,15-18; M Fahim Khan and Mario Porzio, *Islamic Banking And Finance In The European Union* (Edward Elgar 2010) 11–17; Asyraf Wajdi Dusuki., *Islamic Financial System* (International Shariah Research Academy for Islamic Finance 2011).
[148] Mubarak Alsulyman, *Ahkam Altaamul Fe Alaswaq Almalyah* (Knoz Ishbylah, 2005) Pt 1, 15.

governor intending to establish justice within his citizens, has to control the markets and appoint the most trusted people to keep an eye on it. While talking about these people the trouble makers in the market scholar Ibn Alkiyam said: ‘these people are spoiling the interest of the nation, the harm they create is general so the governor must harass and lock them and punish them continuously because their harm affects every body. As such we can see how Islamic law stood against anyone trying to behave in a market in a way that might harm others or create confusion in the market, leading it to lose the purpose of its creation. As discussed we saw how manipulation in the stock market is a calamity and a global harm that should oblige rulers to strongly punish for it in the appropriate way.

3.9.2 Jurisprudential Legislation for Manipulation in the Financial Markets

Regardless of the type of manipulation, in itself it is illegal in the financial market and manifests mainly as verbal deception similar to those deceptions discussed above, i.e. fraud, gyps, cheating, concealment of defects, since all of these behaviours lead to a corruption of information in financial papers and, hence, a real loss for traders.[149]

There is an abundance of evidence in the Holy Qur’an and the Sunnah pointing to the justification of forbidding cheating and fraud. For example, Allah said: ‘O’ you believers, do not consume your wealth among yourselves in falsehood, except where you trade in mutual agreement. And do not kill yourselves. Allah is the most merciful to you.’[150]

Thus, manipulation and deception in financial transactions is forbidden. The difference between the market and the financial market is that the prices in the former are defined by unilateral outbidding (eg a seller and a group of buyers in an auction) or unilateral bidding (eg one buyer and a group of sellers in a government bid), while the control on prices in the financial markets is decided through auctions and outbidding, where sellers compete to decrease prices and buyers compete to

[149] Mohammed El-El-Sehibani and Abdulah El-Omrani, *Rules of Electronic Negotiation in Stock Markets and Views on its Islamic Evidences, Securities Markets and Bourses, Prospects and Challenges* Dubai, 2007) Pt 2, 25.
[150] Holy Qur’an, Surat Al-nisa (4) Ayah 29 (n 11).

raise prices. Deception in the financial market occurs on both sides, by the sellers and the buyers. Vendors try pushing price to decrease and buyers do the opposite.

Qais ibn Saad ibn Ebada said, 'The Prophet said, 'the deceiving is in the hell' [the text states the deceiving as an action is in hell; but it means the deceiver].'[151]

Cheating leads to hell and, accordingly, it attracts a harsh punishment, which seeks to deter such behaviour. Omar's son said, 'The Prophet forbids gyp.'[152] Gyp is detrimental to any contractor since cheating can artificially raise the price of a product; therefore, fraudulence, cheating and concealment in the financial market are forbidden.[153]

3.9.3 The Effects of Manipulation on the Financial Market

There are a number of legal effects of prohibition of manipulation on the financial markets. That is why such attitudes and behaviour are forbidden and invalidate such contracts and request compensation. Manipulation in the financial markets is included in the rules on cheating and actual and verbal deceit. Jurists agreed that the rules consider gyp and informal money exchanges as verbal deception, while fraudulence is deemed 'actual deception'. An overview of jurists' decisions will now be provided.

Most scholars say that exchanging money is forbidden but there are different views about its effects on the validity of a contract. The general consensus among scholars seems to be that a contract is valid but unnecessary. Ibn Taymiya accredited this view to most of the jurists.[154]

A number of scholars have said that:

(i) Nullifying contracts and cancelling transactions within a certain definite time period and repurchasing is legal.[155]

[151] Narrated by Muslim (Hadith number 102), (n 49).
[152] Narrated by El-Bukhari (Hadith number 2142), (n 49); Muslim (Hadith number 1516), (n 49).
[153] Abdulah Alsalmi, *Fraud and its Impact on Contracts*, (Arabic edition Knoz Ishbylah 2004) Pt 1,103.
[154] Ahmed Ibn-Taymiya, *Majmu Alfatawi* (Arabic edition Dar al Wafa and Dar Ibn Hazm) Pt 28, 102.
[155] Saleh Alsultan, *Shares and their Provisions and Implications* (Arabic edition Dar Ibn Aljozi, 2006).

(ii) The validity of the contract and invalidity of the choice and claim back the extra value by the ruler and may levy a fine proportional to his cheating and deceiving.[156]

3.9.4 The Relationship between the Buyer and Seller

Whenever an investor tries to buy shares, then he is called a 'buyer', and when he offers to sell we call him a 'seller'; so the relationship between the two parties is buying and selling even if they did not see each other, such as having representatives from both sides. It is not compulsory to have them present at the signing of a contract in person. Moreover, electronic contracts have similar value with or without the presence of representatives.

The registered information (used as reference when needed) is much more accurate than what both buyers and sellers might know from face to face. The recorded information is useful as a reference when checking back if there is any defect. It is not a condition in selling contract to know the buyer in person or his family or gender. The terms of selling are fulfilled without that.[157]

It may happen that the seller to seduce and cheat others would lead to Islamic provisions such as when cheating in the price of a share done by the owner himself, so he would seduce traders with different hidden and fake tricks to push them to buy his shares or sell their shares, this is what is called 'making false price', i.e. seducing can be done by the buyer as well by creating confusion in the market so traders will sell and he will buy, and these behaviours and tricks build up a need for a warranty. Additionally, the stock market commission issued a decree to stop such manipulations.

Jurisprudence scholars confirmed to the victim (who was cheated) his right to choose such as if there was seducing or lying about the price similar to any action based on trust, ie '*Al-Murabahah*', '*Al-Tawlia*', and '*Al-Wadhia*' (see details in fifth case

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[156] Abdullah El-Sulmi, *'The Rule of Speculation in Financial Markets'* Seminar on 'Speculation and Manipulation in the Financial Markets' (Islamic World League, Islamic International Foundation for Economics & Finance) 102.
[157] Mohammed Abu Alhyja, *Commercial Contract of Electronic*(Arabic edition Dar Althaqafah, 2005) 39–45.

below). There is another opinion confirming the choice and that is the opinion of all four Islamic schools[158] except for a second opinion of Hanbali School where they said the buyer cannot choose but the amount of cheating has to be deducted.[159]

3.9.5 The Relationship between the Buyer or Seller and the Manipulator in the Market (among the Traders)

The relationship between buyer or seller and the manipulator in the market is a relation of warranty because of harm, and that is why in consequence of such warranty, usually the committee of disputes gets involved to decide and resolve the problem. Now if it is proven that there was cheating by seducing in the sales' contract, such as if the owner of the shares has cheated the traders, in this case the victims are to choose, and the committee of the stock market can impose financial penalties on the manipulator proportional to his manipulation, in case where the seduction came from the intermediate (speculator) or so, no matter if the owner of the shares knew or not, the victims have the choice as if the manipulation came from the owner himself.

In Islamic law there are three primary classifications of offences *Hadd*, *Tazir* and *Qisas*.[160] *Hadd* offences are the offences that have a fixed penalty stated in the Qur'an, these are usually more serious offences like theft, consuming intoxicants, etc.[161] *Tazir* offences are punishable offences but the Holy Qur'an does not expressly provide these punishment, this puts these punishments at the discretion of the head of state.[162] *Qisas* offences are offences against the person such as murder, manslaughter and battery.[163] Applying these concepts one can see that Islamic law too maintains a dualistic regime with civil offences being brought privately by individuals in the form of claims in front of the *Qadi* and criminal offences being punished by the Caliph (or in his name by those designated).

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158 Zyan Aldeen Alhanafi, *Albahr Al-Raik* (Arabic edition Dar Alkutub Alarabiah) Pt 6,116; Abdulrahman Almaliki, *Irshad Alsalik IlaAshraf Al-masalik* (Arabic edition Dar Alfathylah, Cairo) Pt 1,185; Yaḥya Ibn Sharaf al-Nawawi, *Rawdhat Al-talibeen* (Arabic edition Almktab Alislami, 1991) Pt 3,188

159 Mohammed Ibn Muflah, *Almubdi-a Fi Sharh Almoqna*, Arabic edition (Dar Alkutub Alilmyah, 1997) Pt 4,102

160 Abu-Zahra (n107).

161 ibid.

162 ibid.

163 ibid.

Market manipulation and insider trading are offences involving dishonesty, in which property (money) belonging to another is fraudulently appropriated. While the act sounds similar to theft, it is far more sophisticated, lacking any of the physical appropriation elements. It is more likely that under Islamic law the offences of Market abuse would be categorized as *Tazir*, which gives the Caliph (or head of state) the discretion to decide the penalty.

In addition, *Tazir* is fundamentally a discretionary power of the ruler, and the legal restrictions on the exercise of that power are more in the form of standards than rules. In keeping with the general considerate of *Tazir* as the means of achieving practical purposes of maintaining public order and morals, the strict evidence rules that encumber the implementation of other forms of punishment do not apply. In Islamic finance through the *Tazir* can give the suitable punishment for manipulator. Financial '*Ta'zeer*'[164] in Islamic law is proven, such as if someone steals animals from an unprotected location, the Prophet punished him, similar to the protected animals if stolen from pasture; the Prophet ruled the penalty twice the price and the thief to be beaten.[165]

As well narrated by Amro Ibn Shuaib through his father through his grandfather who heard a man from Muzaina asking the Prophet (peace be upon him) on his opinion on a lost camel he replied: 'Do not worry about it, it has its food and foot' the man asked what about sheep, the Prophet replied: 'for you or your brother or wolf', the man asked again if someone took it from the pasture, he answered he will be punished and fined its price, and if he released it from its tether or taken out of its yard his punishment is to cut his hand, the man asked, 'O you Prophet, what about fruit while on tree', he said: 'no problem if it is just to eat but if he took it he will be punished and fined its price (in another version he will be fined twice its price).'[166]

[164] A punishment left to the ruler to decide its amount or level.

[165] Narrated by Al-Nassai, Hadith number: 4962 (Darussalaam for Publication and Distribution 1999); Ibn-Majah, Hadith number 2596, (n 142). Shaikh Al-Albani said this Hadith is Hassan. See: Muhammad Nasir al-Din al-Albani, *Irwa al-Ghalil fi Takhrij Ahadith Manar al-Sabil* (Al-Maktab al Islami, Beirut, 1988) Hadith number 2413.

[166] Narrated by Abu Dawood (Hadith number 1710), (n 12); Al-Tirmidhi (Hadith number 1289), (n 12); Al-Nassai (Hadith number 4961), (n 178). Shaikh Al-Albani said this Hadith is Hassan. See: Muhammad Nasir al-Din al-Albani, SahSunan al Nasa'i, (Maktabat al- Maarif, Riyadh, 1996) Hadith number 4961.

All these *Ahadeeth* (Prophet's words) indicate the authorization to fine the manipulators in the prices of shares financially and punish him for seducing and cheating. The *Ahadeeth* can also be understood to require that the sanctions should be made clear, so that all involved parties are fully aware of the penalties for market manipulation.

- Fixed penalties.
- Range penalties.
- Proportional penalties.

The forms of this liaison are not limited, for example the relationship between the brokers (in share issues – such as the financial intermediary companies) and buyers or sellers have never been mentioned, because in reality he represents buyers and sellers so he is legally like them, and if a mistake happens, it is like the representative who committed the mistake; of course there are many more details differentiating if it is an offence or negligence or not.

3.9.6 Jurisprudence Cases Ruling on the Relationship between all Parties in the case of Manipulations in Prices or the Existence of Blemish

Below are samples of jurisprudence cases ruling on the relationship between all parties.

3.9.6.1 First Case: Choice in Case of Blemish

Scholars debated on authorizing the option of choice in the case of blemish in general. Scholar Al-Sabki said: 'There is no disagreement between all Muslims on returning if blemished wholesale',[167] adding 'Alkadhi Abu Tayab claims that all Muslims agreed on treating equally the Deceitful and traitor and others'.[168] Ibn Kodama said, 'Whenever he knew the existence of fault in sales (which he did not know before he is to choose whether to keep or return it, no matter if the seller knew

[167] Yaḥya Ibn Sharaf al-Nawawi, *Takmilat Almajmooa* (Arabic edition Dar Alfikr 1997) Pt 12,122.
[168] ibid; Ismail Kadhimy, *Provision of Blemishing in Islamic Jurisprudence* (Arabic edition Dar Amar 1997).

and hid it or not), I have not heard of any dispute between all Muslim scholars about this.'[169]

Where there is evidence that there is a fault in a share, where the company did not fake it and the buyer discovered it. So he has a right to choose as detailed in jurisprudence books, to his right being confirmed from the time he knew about it, with variations in the length of waiting period for him to make a decision, as well the fault must have an effect on the share according to conditions mentioned by scholars. Now, if the company faked the fault, the judgment will move to 'choice in case of fraud'.

3.9.6.2 Second Case: Choice in Case of Fraud – 'Tadlees'

By fraud, we mean that the commodity will have a hidden fault, and the seller did not tell the buyer about it and hid it from him intentionally. Other scholars described it as the seller hiding the fault from the buyer knowingly, making the buyer think it does not exist.[170] Scholar Ibn Muflah said, 'Al-jawhari said fraud in selling is hiding a fault in the commodity from the buyer like cheating. The fraud confirming the choice comes in two types: one is hiding faults, the other like prettifying commodities to increase the price.'[171] '*Tadlees*' in Arabic means like darkness, so if the fault is hidden, then it is fraud.[172]

The Hanafi School called it seducing and divided it into verbal and practical forms.[173] An example of such fraud is keeping a sheep and not milking it for a few days so that milk will gather in its udder; when the buyer milks it he will feel it is copious.[174] Most scholars confirmed the right of choice, Ibn Kodama said: if a buyer bought a non-milked animal and knew it, he has the choice to keep or return it, narrated by Ibn Messaoud, Ibn Omar, Abu Huraira, Anas, and this is the opinion of

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169 Mohammed Ibn Qudama Al-Maqdissi, *El Moghani* (Arabic edition Dar Alam Alkutub 1997) Pt 4,157.
170 Saadi Abu Habib, *Alkamoos alfik-hi* (jurisprudence dictionary) (Arabic edition Dar Alfikr 1988) Pt 1,132.
171 Mohammed El Baali, *Almuttala Ala Aboab Alfiqh* (Arabic edition Almaktab Alislami, 1988) Pt 1,236.
172 Mohammed Abu Bakir, *Al-zahir* (Arabic edition Dar Alshown Althaqafyah, 1987) Pt 1, 209.
173 Ali Hydar, *Durar Al-hakkam* (Arabic edition Dar Alam Alkutab, 2003) Pt 1,312.
174 Mohammed El Baali, *Almuttala Ala Aboab Alfiqh* (Almaktab Alislami, 1988) Pt 1,236.

Malik, Ibn Abi Layla, Al-shafii, Abu Youssef and many other scholars. Abu Hanifa stated that he does not have to choose.

So they confirmed the choice in the case of fault in general; some disagreed in the case of an 'unmilked animal', but others confirmed the right to return it like the majority of scholars.[175] Ibn Kodama said that any fraud that can cause a change in price, such as making up a woman slave to increase the price, and the buyer has the right to choose to return it. And this can be seen if the company hides information about a share in its journal information related to its financial position and the volume of activities. The choice will be confirmed and the remaining confirmation conditions will apply.

3.9.6.3 Third Case: Choice in Case of Unfairness – 'Ghobn'

Ghobn or unfairness', means cheating in trading;[176] the unfairness will be confirmed if it is too big, or if the buyer or seller does not know the price or does not know how to bargain (so-called *Mustarsil*), or intercepting sellers before arriving to the market, most scholars forbade the interception, but the Hanafi School did attach two conditions to forbidding: first, if the interception will affect people of the city, and second, if it confuses the incoming traders on the price; if these two conditions are not met there then no problem will apply with interception.[177]

Some of Shafi' school stated the forbidding,[178] but most Shafi's,[179] Hanbali scholars,[180] and some Maliki scholars stated the option of choice.[181] A third opinion (by Imam Ahmed (scholar) and some companions of Malik) is that the selling contract, while intercepting, is null because the forbidding means deprivation.[182] The clear evidence of confirming the choice is the Hadith of the Prophet (peace be upon him): 'Do not intercept, if you did and bought from it, once in the market the seller

[175] Zyan Aldeen Alhanafi, *Albahr Al-Raik* (Arabic edition Dar Alkutub Alarabiah) Pt 6,51.
[176] Omar Alnasafi, *Talabat Al-talabah* (Arabic edition Almatbah Alamerah) Pt 1,126.
[177] Zyan Aldeen Alhanafi, *Albahr Al-Raik* (Arabic edition Dar Alkutub Alarabiah) Pt 6,108.
[178] Mohammed Alkhateeb, *Moqni Almuhtaj* (Arabic edition Dar Alkutub Alelmyah 1994) Pt 2,36.
[179] Zakarya Alansari, *Asna Al Matalib Sharh Rawdhat Al talib* (Arabic edition Dar Alkutub Alelmyah 2000) Pt 2,38.
[180] Mohammed Ibn Muflah, *Almubdi-a Fi Sharh Almoqna* (Arabic edition Dar Alkutub Alilmyah, 1997) Pt 4,77.
[181] Mohammed Al-dasuki, *Hashiat Al-dasuki aly alSharh alKabir* (Arabic edition Dar Alkutub Alilmiyah2010) Pt 3, 54
[182] ibid.

has the option to choose.'[183] Also the confirmation of choice for the '*Mustarsil*', as mentioned above, a *Mustarsil* is someone who does not know how to bargain, so he leaves it to the seller, whatever he would give him he will accept without bargaining or knowing that has been treated unfairly (as defined by Imam Ahmed). Ibn Kodama defined '*Mustarsil*' as the one who ignores the price of commodities and does not know how to trade.[184] Some Maliki scholars[185] and Hanbalis'[186] confirmed the option of choice, but Hanafi scholars confirmed it with a condition of proving seduction (to ease life or people). In an apparent opinion of the Hanafi School the return option will not be guaranteed if the goods are intact and the buyer did not commit fraud, it is the buyer's mistake of note checking, so the return will not be authorized.[187]

3.9.6.4 Fourth Case: The Option of Choice in Price Whenever it is Proven More or Less

The option of choice is in the following cases:

In Islamic finance, '*Tawlia*' is defined as selling at the same price as buying a commodity.[188] '*Sharikah*' means selling part of the commodity with its accorded price.[189] '*Almurabahah*', which means selling at the cost price plus a fixed amount of profit.[190] Finally, '*Almuwadha'a*' means the seller saying to buyer that I am selling it to you at its' price less (for example) one dirham from every ten.[191]

The confirmation of the option of choice is the opinion of all four schools excepting some Hanbali scholars who stated the buyer cannot return the items but can deduct the value of cheating.[192]

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183 Narrated by Muslim (Hadith Number 1519), (n 49).
184 Mohammed El Baali, *Almuttala Ala Aboab Alfiqh* (Arabic edition Almaktab Alislami, 1988) Pt 1,236.
185 Ali Altasoli, *Albahja fi Sharh Al Tuhfa* (Arabic edition Dar Alkutub Alelmyah, 1998) Pt 2,176.
186 Mohammed Ibn Qudama Al-Maqdissi, *El Moghani* (Arabic edition Dar Alam Alkutub, 1997) Pt 4,92.
187 Zyan Aldeen Alhanafi, *Albahr Al-Raik* (Arabic edition Dar Alkutub Alarabiah) Pt 6,125.
188 Omar Alnasafi, *Talabat Al-talabah* (Arabic edition Almatbah Alamerah) Pt 1,307.
189 Mohammed Ibn Muflah, *Almubdi-a Fi Sharh Almoqna* (Arabic edition Dar Alkutub Alilmyah 1997) Pt 4,104.
190 Omar Alnasafi, *Talabat Al-talabah* (Arabic edition Almatbah Alamerah) Pt 1,307.
191 Mohammed Alzarkashi, *Sharh Al Zarkashi* (Arabic edition Dar Alubykan 1993) Pt 2,57.
192 See: Zyan Aldeen Alhanafi, *Albahr Al-Raik* (Arabic edition Dar Alkutub Alarabiah) Pt 6,161; Abdulrahman Almaliki, *Irshad Alsalik IlaAshraf Al-masalik* (Arabic edition Dar Alfathylah) Pt 1,185;

3.9.7 Islamic Ruling on Manipulations

We saw earlier the issue of intercepting merchants, city men to offering to sell goods of a countryside man , *Najash* and how they can harm people. I will discuss here different opinions of scholars on the effect of *Najash* selling contracts because *Najashis* the closest form of trading to the manipulations in stock market; what it contains is the increase of the prices and stimulating buyers to buy due to higher unreal bidding offers, and this is what is happening in stock markets nowadays.

Imam Tirmidhi (may Allah grant him mercy) said, '*Najash* happens if a man come to a dealer and offer him a high price just with the intention to make other buyers stimulated (not with intention to buy himself), and this is a sort of cunning and guile.'[193] Imam Tirmidhis' description is as if he is talking about what is happening nowadays in stock market. Scholars have three different opinions about contracts with the existence of *Najash*:

3.9.7.1 First Opinion

The sale is true but the buyer has a right to choose to keep or nullify it, and this is the opinion of the Maliki School,[194] Shafi' School,[195] Hanbali School,[196] and both Ibn Hazm[197] and Ibn Taymiya[198].

1) The onus for prevention lies with the one who practises *Najash* not the one who signs the contract.

2) Islamic law did not prevent *Najash* as God's right, but because it is a man's right who has been cheated and betrayed so he reserves the right to keep or nullify it.[199]

Zakarya Alansari, *Asna Al Matalib Sharh Rawdhat Al talib* (Arabic edition Dar Alkatab Alislami) Pt 2,92; Mohammed Ibn Muflah, *Almubdi-a Fi Sharh Almoqna* (Arabic edition Dar Alkutub Alilmyah 1997) Pt 4,102.

[193] Imam al-Tirmidhi, Mentioned after Hadith 1304, (n 12).For more information see: Mohammed Alqahtani, `Alnajash` (2006) 29 Al-Adl Journal – Ministry of Justice, 105-106.

[194] Mohammed Altarabulsi Alhtaab, *Mawahib Al Jaleel* (Arabic edition Dar Alfekir 1992) Pt 4,378.

[195] Yaḥya Ibn Sharaf al-Nawawi, *Al Muhadhab* (Arabic edition Dar Alfikr, 1997) Pt 1,291.

[196] Mowafaq Aldeen Ibn qudamah, *Al Sarh Al Kabeer Maa' Al Insaaf* (Arabic edition Dar Hajir, 1993) Pt 11,340.

[197] Ali Ibn Hazm, *Almuhalla Bl Athar* (Arabic edition Dar Alkutub Alilmyah, 1997) Pt 8,448.

[198] Ahmed Ibn-Taymiya, *Majmu Alfatawi* (Arabic edition Dar al Wafa & Dar Ibn Hazm) Pt 29, 283.

[199] ibid.

3) Comparing with the intercepting of merchants, where the Prophet (peace be upon him) left for them the choice once they arrive to the market, and this is a correction of the contract and confirming the choice.

3.9.7.2 Second Opinion

The deal is void, and this is an opinion of Imam Ahmed and some Hadith scholars.[200]

Proof:

For them forbidding means deprivation, and *Najash* has been prevented in true Hadiths.

We can argue that if the prevention is because of a fault in the prevented good, then it voids it, but if the cause is external –as in our cases- this will not void it, that is why we can see that even the Prophet prevented interception but still he kept the choice option to the seller once in the market.

3.9.7.3 Third Opinion

The deal is correct and obligatory, and there is no way to terminate the contract without the agreement of both parties. This is the opinion of the Hanafi School,[201] another opinion of Imam Ahmed, and the most correct opinion in the Shafi' School.[202]

Proof:

1) It is the buyer's fault, as he neglected to make sure or to seek advice from others who knew the prices better.[203]

2) The issue is in an external issue not in the sale itself.[204]

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[200] Ali Alasqalani Ibnhajar, *Fath ul-Bari fi Sharh Sahih al-Bukhari* (Arabic edition Dar Al-Riyadh 2001) Pt 4,355.
[201] ibid Pt 5,239.
[202] Yaḥya Ibn Sharaf al-Nawawi, *Rawdhat Al-talibeen* (Arabic edition Almktab Alislami 1991) Pt 3, 414.
[203] Ibn Qayyim al-Jawziyyah *I'laam ul Muwaqqi'een 'an Rabb il 'Aalameen* (Dar Ibn Aljawziyy 2008) Pt 3, 240.
[204] ibid.

3.9.7.4 The Preponderant

It is an evidentiary fact that the option addressed first consists of all the evidences and hence recommended. However, the option third lacks to address the rights of the victims therefore, is on the weakest side. Based on the above, the dealing made by the victim of any of the above methods, his trading in the stock market is correct but still preserves the right to keep or nullify the deal,. Usually, he will choose to nullify, especially if the loss is heavy.

The penalties and fines made against some manipulators who violated the Saudi stock market system contained an obligation for the violating trader to pay back all that has been gained through these violations,[205] but did not state whether the victims would be repaid whenever they are determined by working out the number of transactions related to the shares in question.

Other systems have proposed a different way of punishment, by cancelling all transactions related to that particular share and all implications from the beginning of the violation to the end.[206] It is suggest that this is an annulment of the contract and I believe this is a wise choice, though most dealers like the annulments due to their heavy losses.

Nowadays, catching any dealings related to any share during any given period of time may be easy to be easily facilitated, to a situation back to its original place before the dealers started manipulating. Of course it does not mean not punishing the violators to deter them, and cancelling all transactions by the violators.

3.10 ***Al Hisbah:***

Al *Hisbah* (ombudsmanship) is a function of supervising the activities and transactions that take place in the market from three angles. One, that all activities and transactions are undertaken within the boundaries of the rules of Shari'ah; two, that all activities and transactions are done with observation of the moral values and ethical principles of Islam as a religion; and three, the ombudsman (Muhtasib) is also

[205] Al Barbary Saleh, 'Speculation and Market Manipulation' (2007).
[206] ibid.

charged with the function of “ordaining what is known as good and forbidding what is known as wrong” in the market.[207]

Whatever Allah commands us to do, whether it is Wajib or Mandub is Ma’ruf or Good. It is good because a healthy conscience agrees with it. Munkar on the other hand is whatever Allah asks us to refrain from doing, whether it is Haram or Makruh, it is Evil and Wrong because a healthy conscience abhors it. Mere liking or disliking does not make a thing Ma’ruf or Munkar, but how Allah labeled it. Human intellect only confirms and understands what is transmitted as such.[208]

These functions have been implemented throughout Islamic history from the time of the Prophet Muhammad (pbuh) until the end of the nineteen-century. In fact, there were Muhtasibs all over the Islamic history. We should keep in mind that when a society goes down or deteriorates in its cultural standards or at least stagnates, all functions including those of the Muhtasib go along with the general decline or stagnation.[209]

The idea of the Muhtasib tells that one of the major objectives of market regulations is to promote a two-tier filtration of economic activities and transactions. That is, the filtration at the level of the consciousness of the economic actor and within his/her heart and the filtration at the level of monitoring the observance of legal and moral values and rules in market relationships by a special semi-governmental agency. This second filtration comes from the presence of the Muhtasib in the market and her/his authority in ordaining what is good and preventing what is wrong. It should be noted that the authority of al Muhtasib lies somewhere between personal moral advices and supervision on the one hand and a legally binding action of a judiciary system on the other hand. In other words, the Muhtasib’s authority is a little below a judge who gives final dictates on the compliance of transactions and economic relationships with the rules of Shari’ah.[210]

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[207] Ibn Taymiyyah, Ahmad, *Al Hisbah fi al Islam*, (edited by Muhammad al Mubarak, Dar al Kutub Al Arabiyyah1967); Fauzan Saleh, The Institution of Hisbah: Its Roles in Nurturing Fair and Just Economic System in Islam (the National Conference On Islamic Economics 2009 on 10th-11th February 2009 University Malaya.

[208] ibid.

[209] Al Mubarak, Muhammad, Al dawlah wa Nizam al Hisbah Inda ibn Taymiyyah, (Dar al Fikr 1967).

[210] Al Shirazi, Nihayat al Rutbah fi Talab al Hisbah, (edited by al Arini, Lajnat al Ta’lif wa al Tarjamah wa al Nashr Publishers, Cairo1946)

Thus, while the Muhtasib must protect economic freedom of individual actors she/he must also see to it that no actor abuses this freedom and transgress on other's ability to practice their respective freedom.[211]

3.10.1 Tools of Market Regulation in the Private Sector:

The Hisbah (A Regulatory Agency):

It is important at the outset of this subsection to remind us of the nature of the institution of *Hisbah* and its historical role and functions in the Muslim market. It may be one of the most deep-rooted institutions of market regulation, not only in the Islamic history, but also in the history of mankind at large.

It is irrelevant and perhaps futile to argue whether *Hisbah* is an Islamically created institution or it existed before Islam. What matters really is that it is an institution that existed since the time of the prophet (pbuh) and it continued since then, with an important market role, to the extent that it has become a powerful institution that was intrinsically attached to the Muslim markets throughout the economic history of Islam. It is reported that the prophet Muhammad (pbuh) was the first ruler in the Islamic history that practiced the *Hisbah* on the market. And it was assigned to outstanding and Shari'ah-knowledgeable persons ever since the death of the prophet (pbuh).[212]

The Muhtasib (ombudsman) has assistants around him and can enforce her/his decisions with the help of the law enforcement agencies. The word itself is derived from *Hisab* (account/accountability), and the institution of *Hisbah*, was assigned several market functions in the Islamic history and jurisprudence.[213] These functions include the following:

1. Quality control, whereby all kinds of products were subjected to quality checks and supervision to maintain a quality standard that is desired by the society.

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[211] Ibn Taymiyyah, Ahmad, Al Hisbah fi al Islam, (edited by Muhammad al Mubarak, Dar al Kutub Al Arabiyyah1967).

[212] ibid.

[213] Fauzan Saleh, The Institution of Hisbah: Its Roles in Nurturing Fair and Just Economic System in Islam (the National Conference On Islamic Economics 2009 on 10th-11th February 2009 University Malaya; Ahmad Bello Dogarawa, 'Hisbah And The Promotion Of Ethical Business Practices' (2013) 6 I J Islam Mid East Fin and Mgt.

2. Shari'ah control. This function includes the supervision of the market actors from the point of view of the compatibility of their contracts with the Shari'ah, that no Riba contracts are done, no deception neither fraud, etc. are practiced.
3. Moral filtering. This function includes that all actors in the market in their transactions are observing the moral and ethical values of the Shari'ah. These include truthfulness in transaction and declarationof all the characteristics of merchandise, apprentices are not treated unfairly, animals are not over-burdened or underfed, etc.
4. Environment control. This includes that all transactors do not exceed their own domain of practice. For instance, merchants do not exhibit goods and merchandise in the street outside their own shops, hence infringing on the right of purchaser and passers-by to the whole street; craftsmen don't produce fumes or other particles that may hurt passers-by or neighbors; noise-producing craftsmen have shops away from residential areas and other businesses, etc.[214]
5. Health control. The *Hisbah* institution was also assigned the function of health control in the Islamic market. For instance, it is required to see to it that merchandise may not be exposed to insects, their production is done under healthy conditions, no harmful or rotten ingredients are used by the producer, that producers of bread, meat, and other ready food items follow all rules of cleanliness to the extent that they were forced to employ a worker to stir the air continuously to scare away flies and other insects, to wash with soap (Muslims invented soap), to cover their nose, mouths, and all their hair when they deal with dough and the fresh bread, etc. In fact, you find in the classical books on Hisbah a detailed description of health and cleanliness rules and suggested methods of inspection, including surprise visits, etc.
6. The arbitration function. The *Hisbah* institution was also assigned the function of arbitration in market disputes between workers and employers as well as between sellers and buyers and between the merchants themselves. In this sense the *Hisbah* represents an agency that provides quick and immediate arbitration to solve disputes before they reach the court so that once the two

[214] Al Mubarak, Muhammad, Al dawlah wa Nizam al Hisbah Inda ibn Taymiyyah, (Dar al Fikr 1967).

parties accept the arbitration of the Muhtasib, any of the Muhtasib assistants or sometimes a committee formed by the Muhtasib, the dispute is usually solved on the spot without waiting for court procedures.[215]

7. Anti-monopoly functions and pricing. The *Hisbah* institution was also assigned to see to it that no monopoly is practiced in the market, the type of monopolies mentioned in the books of *Hisbah* where the Muhtasib has to interfere include an implicit agreement between producers to raise the prices of their services or goods, the existence of one producer/seller of a commodity if he/she hoards or stores a commodity in order to reduce the market supply.If a commodity is actually produced by one single producer, then the Hisbah institution must enforce pricing, as argued by IbnTaymiyyah and others. Hence this function includes pricing if it becomes the only way to eliminate monopolistic practices.
8. The supervision over the continued provision of public utility services in the market and society. The *Hisbah* institution was also assigned the task of seeing to it that the public utilities are maintained in a proper way. These include roads, bridges, and streetlights. Water fountains for homes and Mosques, public bathrooms, drainage, sewage, etc. If any of these public services is damaged or affected by wear and tear or naturally calamities, the *Hisbah* institution steps in to supervise repair and maintenance, and if there are no financial resources in the treasury of the local government, help from the center is sought or taxes are imposed on the rich for repair and maintenance of public services.[216]

This institution of *Hisbah* had a heritage in all Islamic countries and major cities. This was developed in the Muslim societies at the time when Europe was sinking in ignorance and barbarism. The institution of *Hisbah*, once revived, represents a semi-governmental agency that takes charge of several aspects of market regulations especially those that do not fall under the macro policies. It can be charged with all or most of the abovementioned functions of which we have a rich historical

[215] ibid.
[216] Ibn Taymiyyah, Ahmad, Al Hisbah fi al Islam, (edited by Muhammad al Mubarak, Dar al Kutub Al Arabiyyah1967).

experience.There remain the other tools of direct regulations of the market and the macro-lend regulations, which will be discussed in the following subsections.[217]

3.11 Conclusion

Financial lawmakers, who govern contacts, require *Ijtihad* and the *Ikhtilaf* to reconcile the complex issues, which relate to financial law. As financial contracts, derivatives and other principles require innovation to comply with financial rules, the need for Ijtihad in aid of expert knowledge from jurists is critical and necessary. This will ensure any change or a difference in approach is in line with the Qur'an and the Sunnah.

Ijtihad and *Ikhtilaf* have a limited, but permissible, leeway of variance, as opposed to a rigid set of rules. This does not mean, in turn, that one can pick and choose, nor does it mean no established set of fundamental principles require conforming to. There are indeed fundamental principles in which *Ijtihad* and *Ikhtilaf* are forbidden; however, in our discussion at present, we are arguing room for opinions in certain cases and certain minor principles, which relate to Islamic finance.

The financial crisis of 2008 arose because of persistent levels of debt through usury and expansion of the tools that are used to manage risk.[218] This has resulted in a 'who dares wins' situation, whereby those who take the biggest risk benefit the most; consequently, a social imbalance has been created, where there is an increasing gap between the rich and poor in society.[219]

Islamic economics presents the basic principles, such as the prohibition of usury, agreed upon by mainstream religions in the world. This has changed the lending system, so that a failure to repay a loan does not result in accrual of interest by the individual, but rather the lender is encouraged to give the borrower time to repay. It

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[217] ibid; Ziadeh, Nichola, Al Hisbah wa al Muhtasib fi al Islam, (old texts collected and edited with an introduction, Catholic Press 1962); Al Shirazi, Nihayat al Rutbah fi Talab al Hisbah, (edited by al Arini, Lajnat al Ta'lif wa al Tarjamah wa al Nashr Publishers, Cairo1946)

[218] Sami alsuwailm, 'Financial Crisis' (Imam Muhmmad Ibn Saud University 2010) <suwailem.net/books-187.htm> accessed 27 November 2015.

[219] ibid.

also offers systems to support the poorest in society, such as *Zakat*[220] and Islamic insurance (*Takaful*).[221] These principles protect financial markets from sources of imbalance and deviation in economic activity that could lead them to fall into crisis and subsequently create global economic and human disasters. If we avoid these imbalances, the market will function more transparently and foster economic stability.[222]

An Islamic economy achieves a balance between the profit sector (represented by the market) and the non-profit sector (represented by social institutions); finding this balance helps to contain the negative effects of the market.[223] In a scientific study conducted by a sector of the economic world, it was confirmed that the profit sector should be maintained to support the non-profit sector and encourage that, which will bring stability to the economic market.[224] In order to underpin my arguments the next chapter will be based on a critical analysis of market manipulation in the US.

[220] *Zakat* is a compulsory payment of 2.5 per cent of a person's wealth that is distributed to the poor through charities.
[221] *Takaful* in Islamic finance is similar to insurance in Western finance: PwC, 'Financial Services' (*PwC*) <www.pwc.com/gx/en/financial-services/islamic-finance-programme/takaful-growth-opportunities.jhtml> accessed 28 November 2015.
[222] Dr Abul Hassan, 'The Global Financial Crisis and Islamic Banking' <www.islamic-foundation.org.uk/IslamicEconomicsPDF/Hassan-financialcrisis-if.pdf> accessed 28 November 2015.
[223] ibid.
[224] Sami alsuwailm (n 216).

CHAPTER 4: THE US LAW OF MARKET MANIPULATION

4.1 Introduction

This chapter will be on regulation of market manipulation in the USA. The chapter will divide into three sections. The first section deals with how manipulative practices have evolved and how such changes have affected the markets today. The second section examines the definition of manipulation under US law. The third section deals with the legal development of US market manipulation law.

4.2 The Background to Market Manipulation in the US

Before beginning, it is pertinent to explain that market manipulation refers to a wide range of deliberate activities and/or practices which have as their aim the disruption of and interference with the free operation of the market.[1] One of the earliest examples of this phenomenon was price-fixing. Over the centuries, price manipulation has been conducted through a number of technical means within the financial markets. Both governments and professional traders have faced challenges when it comes to controlling speculation[2] and price manipulation in commodity markets.[3] Concerns over commodity price manipulation have emerged continuously in the history of America. During the American Revolution, the prices if essential commodities were so inflated that George Washington termed speculators 'monopolisers, forestallers, and engrossers',[4] declaring that they were the 'murderers of our cause' and should be 'hung in the gibbets'.[5] Infuriated by the speculators'

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[1] Van Smith, 'M, Preventing the manipulation of commodity futures markets: to deliver or not to deliver?' (1981) 32(6) Hastings Law Journal, 1956, 1580-1581.

[2] "Speculation on commodity future has been justified for a variety of reasons: (1) Forecasting by speculator promotes short run stability of prices and the prompt and efficient adjustment of consumption to relatively fixed supplies" 'Manipulation of Commodity Futures Prices: The Great Western Case' (1953) 21(1) University of Chicago Law Review, 94, 95.

[3] Smith (n1) 1581-1582.

[4] An Acte Against Regratours, Forestallers and Engrossers, 5 & 6 Edw. 6, c. 14 (1552). Engrossing was the practice of cornering supply by large purchases of a commodity. Forestalling consisted of intercepting suppliers on the way to a market and buying up commodities. Regrating was the creating of an artificial scarcity by buying up goods in the market and reselling them in or near the same market. Smith (n1)

[5] James T Flexner, *George Washington: The Forge of Experience (1732–1775)* (Little, Brown and Company 1965) 337–38; Smith (n1) 1571.

activities, Washington lamented 'But, alas! Virtue and patriotism are almost extinct. Stock-jobbing, speculating, engrossing seem to be the great business of the multitude, whilst a virtuous few struggle, lament, and suffer in silence'.[6] During the Revolution, 'forestallers' would intentionally withhold goods from the market and, preferred to trade with their 'allies', the French soldiers who could pay in hard currency.[7]

The image of speculators in America did not improve after the American Revolution. William Duer and Alexander Macomb attempted to completely monopolize the stock market in 1792. This resulted in Duer's bankruptcy, initiating panic throughout New York[8] and becoming a fundamental reason for the establishment of the New York Stock and Exchange Board, the predecessor to the New York Stock Exchange (NYSE).[9] Duer and Macomb's manipulation of the market was so profound that the NYSE constitution explicitly prohibits 'fictitious' sales. This prohibition came into existence after the stock of a manufacturing bank was fictitiously sold with the intention of creating a false price.[10]

Shoemakers (or 'cordwainers', as they were known in 1809) were brought before the Supreme Court of New York for forming a 'club' that refused to work for employers who employed non-union workers who did not pay proper wages.[11] The prosecuting counsel was particularly energetic in extrapolating the harms of what might follow if these cordwainers were allowed to exert such influence, persuading the Supreme Court by the following argument:

> Suppose all the bakers in N.Y. were to refuse to bake till they received an exorbitant remuneration… and if there be impunity for these, why shall not all other artisans do likewise?[12] … Suppose that some rich speculators… should, in a cold winter, combine to purchase up all the

[6] George Washington to Henry Laurens, 5 November, 1779: *The writings of George Washington; Correspondence and miscellaneous papers* Vol VI (Boston 1840) 397. And also see: Christopher Hibbert, *Redcoats and Rebels* (Norton 1990) 258.
[7] Willard Randall, *Benedict Arnold: Patriot and Traitor* (William Morrow and Co 1990) 478.
[8] Federal Reserve Bank of Philadelphia, the first bank of United States. See: Federal Reserve Bank of Philadelphia, *Annual Report of the first and second banks of the United States: The Historical Basis for a Decentralized Fed* <https://www.philadelphiafed.org/publications/annual-report/2009/first-and-second-banks> accessed 23 November 2015.
[9] Jerry W Markham, *A Financial History of the United States: From Christopher Columbus to the Robber Barons* (1492–1900) (ME Sharpe 2002) 109–24.
[10] Walter Werner and Steven T Smith, *Wall Street* (Columbia Press 1991) 32.
[11] *People v Melvin*, 1 Yates Sel Cas 112 (NY Sup Ct 1809).
[12] ibid 121-22.

wood, and refuse to sell it but at an extravagant advance, should we have no law to protect the poor against such oppression?[13]

During the early 1800s, the future delivery of securities (also known as 'time options' or 'time bargains') was widely used for stock manipulation.[14] A significant portion of NYSE trading involved time bargains that were six months in duration. These contracts were secured only by a nominal deposit: 'Time bargains rarely consisted of a direct exchange of stock; the parties were more likely to settle by paying the difference between contract and market prices.'[15] Twenty per cent of the trading volume on the NYSE consisted of time bargains.[16]

During the 1830s, market manipulation became commonplace in the NYSE. One example in 1834 was of particular importance: the Canton Company drove up their share price from $60 (the fair market value) to $300.[17] At around the same time as this, the Morris Canal and Banking Company was strategically targeted by a group of traders who had interests tied up in time bargains. These traders were settling price differences between one party or another; the Morris Canal stock rose from 'almost nothing' to $185 a share, showering these traders with profits in the range of 300 per cent.[18]

In 1834 there was also considerable manipulation of the United Mexican Mining Company stock, and in 1835 the Harlem Railroad delivery of future stock was cornered.[19] A famous speculator of his time, Jacob Little, short-sold during the stock market panic of 1837 and 'was widely condemned'.[20]

In 1853, Henry Boardman had complained that gambling in stocks was as much in vogue as card gambling or billiards, '[b]ut the public sentiment tolerates and shelters

[13] ibid 122.
[14] Edmund C Stedman, *The New York Stock Exchange* (Greenwood Press1969) original work published 1905) 445.
[15] Werner and Smith (n 10).
[16] Markham (n 9) 160.
[17] Werner and Smith (n 10) 72.
[18] ibid.
[19] ibid 162.
[20] Thomas L Hazen and Jerry W Markham, *Broker-Dealer Operations under Securities and Commodities Law* (Thomson/West 2011) 1–19.

it'. Even worse, 'it lavishes its respect and its honours up the men who win the most bets and carry off the largest stakes'.[21]

During the market panic of 1857, Americans again voiced concern over speculation and stock pricing manipulation. Time bargains were blamed for the bubble that preceded the major panic.[22] Nevertheless, speculation continued unhindered, including throughout the Civil War. Speculation during this period was typically undertaken through 'put and call' options on approximately ten NYSE exchanges during the 1860s.[23]

The most effective stock market manipulations of the Civil War included The Fort Wayne & Chicago Railroad, the Michigan Salt Combine, the Chicago & Rock Island Railroad, and the Michigan Southern & Northern Railroad. Michigan & Prairie du Chien Railroad stock was cornered and pushed up to $275 from $57, then pulled back down to $110.[24]

The discovery of oil in Pennsylvania gave rise to a significant amount of speculation.[25] The 'petroleum mania' of 1863 created many oil companies which then sold their shares to the public.[26] The Petroleum and Mining Board in New York was where 'corners were frequent and large sums exchanged hands in the dexterous manipulation of value.'[27] These exchanges were in oil company stocks that were repeatedly manipulated. One of the main examples of stock interference was the Napoleon Oil Company, whose share price was driven up to $32 from $2.[28] This particular bubble lasted for a number of years.[29]

4.3 Manipulation in the Historical Commodity Futures Markets

Over the past fifty years there have been increasing volumes of futures trading. The results from the Futures Industry Association reveal that the volume of futures

[21] Jonathan Lurie, 'Speculation, Risk, and Profits: The Ambivalent Agrarian in the Late Nineteenth Century' (1972) 46(2) Agricultural History Society 276.
[22] Markham (n 9) 202.
[23] Hazen and Markham (n 20) 1–26.
[24] Stedman (n 14) 184–192.
[25] James D Hamilton, *Historical Oil Shocks* (National Bureau of Economic Research 2011).
[26] Markham (n 9) 243–44.
[27] ibid.
[28] ibid 244.
[29] PT Barnum, *The Humbugs of The World*, (Carleton 1866) ch XXXIV.

trading in 1960 was 3.9 million contracts and this had increased to 13.6 million contracts by 1970.[30] By 1980, this had increased to 92 million contracts, and to 250 million contracts by 1988.[31] The extreme increase in volumes of futures trading was due to a high rate of inflation encountered between 1960 and 1970, which led to high commodity prices.[32] A further factor that led to increased volume of future contracts was the alteration of monetary policies. In addition, there was a development of many new financial futures contracts.[33]

By 1982, it had been noted that the volume of trading had risen to 42 million contracts. This was a considerable amount of growth since 1981, when the volume of the financial futures trade was 29 million contracts. Five years before, this volume was 4 million. Moreover, by 1988, 180 million contracts had been attained. This revealed high rates of growth in financial futures trading. As compared to agricultural commodity futures, trading in financial futures has been booming. In this case, the agricultural commodity trading volume was 60 million in 1988.[34] There have been many expressions of apprehension from various sides concerning futures commodity trading.[35]

However, futures commodity trading continues to play a crucial role in prevarication and price-finding. 'Hedging' can, in this case, be described by using an example of an extensively spread portfolio manager. When such a manager foresees a fall in the market, he or she can decide to sell the portfolio. By doing so, the manager can avoid potential losses but this can lead to undesirable results. He or she will have to spend a large amount of money in such transactions. In addition, extreme losses may be encountered if other traders in the market become aware of the managers dealing to off-load such a large portfolio. Secondly, the portfolio manager has an option of entering into a futures contract on a Standard & Poor's (S&P) stock index, in order to

[30] Futures Industry Association, *International Report, Volume of Futures Trading: 1960 Through* 1990 Cite in Folkerts-Landau, D., Mathieson, D. and Schinasi, G, *International capital markets* (Washington, DC: International Monetary Fund 1997); Trading Volumes, FIA REVmW (March/April 1990) 5.
[31] *Katara v DE Jones Commodities*, 835 F2d 966 (2d Cir 1987).
[32] Commodity Futures Trading Commission Act of 1974, *House Report, Document Number: 93–975* (April 1974) 93d Cong.
[33] Jerry W. Markham, 'Fiduciary duties under the Commodity Exchange Act' (1992) 68(2) Notre Dame Law Review, 199, 204; Y.L.A. Eason, 'Financial Futures: A Hot New Act' *New York Times* (New York, 24 April 1983) 1.
[34] *Trading Volumes* (July/August 1990) FIA Review 5.
[35] Donald A. Campbell, 'Trading In Futures Under The Commodity Exchange Act' (1957) 26 George Washington Law Review 215, 218–19.

avoid losses in the portfolio. If the market drops as predicted, the portfolio manager will then gain profits in the upcoming contract, which will help to counterbalance losses on the real portfolio. Conversely, if the market does well, the portfolio manager will lose any potential profit. As such, gains will be counterbalanced by future losses of the contract.[36]

Futures contracts have the advantage of price discovery. Traders obtain prices from the Board of Trade and so are able to know the price of any given goods at any time. For example, price discovery has played a crucial role in the agricultural sector.[37] Farmers are able to learn the prices of various agricultural products (such as crops and livestock) by checking the exchange values. Price discovery in recent years has been made easy by financial futures contracts.[38]

The role of entrepreneurs and speculation in the market is acknowledged by the Commodity Futures Trading Commission (CFTC) and Commodity Exchange Act. They assist in price-finding and hedging roles. Financial instruments in the market are valued by the future contracts. Both the CFTC and the Commodity Exchange Act offer sufficient information to allow effective price discovery to be undertaken in the market. They offer liquidity to counterbalance hedging dangers that can be encountered. Nonetheless, the Commodity Exchange Act controls excess speculation and averts the manipulation that generates fake prices and weakens the price-finding and hedging roles of the prospect markets. Market manipulation is a practice of market supremacy in a futures market, and is a felony under United States commodity law. However, recent court and regulatory verdicts have made the conviction of manipulators challenging.

At the same time, controllers have attempted to avert manipulation in a number of different ways. Prevention is preferable to avoidance when manipulations can be identified *ex post* with a high likelihood of prosecution. This capability of detecting manipulation consistently suggests that existing guidelines around the manipulation

[36] *Katara v DE Jones Commodities*, 835 F2d 966 (2d Cir 1987).
[37] Commodity Futures Trading Commission Act of 1974, PuB L No 93–463, 88 Stat 1389 (1974).
[38] Thomas Applegate Hieronymus, *Economics of Futures Trading, For Commercial and Personal Profit* (2nd edn, Commodity Research Bureau 1977) 72-76.

of futures and securities markets are ineffective, as they depend on costly preventative measures, rather than *ex post* prevention.[39]

4.4 Early Manipulations

There is a long history of trading in commodity futures.[40] In the US, this history can be traced to the end of the Civil War and, specifically, to the Chicago Board of Trade. Contracts for the supply of grain were changed into movable contracts that were repeatedly used to counterbalance each other.[41] Speculators quickly gained an understanding that these contracts provided openings for individuals to take part in underhand actions and also to make assumptions.[42]

So-called 'corners' and 'squeezes' gained popularity, and manipulators became viewed as legendary, as demonstrated by the story of Joe Leiter, a former Harvard student who made an unsuccessful attempt to turn the wheat market. His corner was destroyed after ships rented by P. D. Armour manipulation of commodity futures prices made their way through the ice on Lake Michigan and flooded the Chicago markets with grain.[43] A well-known event corner by Gould and Fisk in the gold market turned out to be a myth of American's past.[44] Great manipulations took place until the twentieth century.[45]

Some operators made huge profits through the wheat squeeze. James A Pattern made a profit of up to two million dollars by raising the price of wheat per bushel from 1 dollar to 1.34 dollars.[46] Jesse Livermore used strategic tactics in his manipulation. He used a New York newspaper, which had information of him cornering the July cotton market on its front page to inflate the value of his purchases, due to the fact

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[39] Johan H. Stassen, Propaganda as Positive Law: 'Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress)' (1982) 58 Chi Chicago-Kent Law Review 635.
[40] Van Smith, 'Preventing the Manipulation of Commodity Futures Markets: To Deliver or Not to Deliver?' (1981) 32 Hastings Law Journal 1569, 1571.
[41] Harold S. Irwin, *Evolution of Futures Trading* (Mimir 1954) 80.
[42] Hieronymous (n 38) 72–76.
[43] Leon T. Kendall, 'The Chicago Board of Trade and Federal Government: A Study of their Relationship, 1848 to 952' (unpublished dissertation, University of Indiana Business School, 26 May 1956) 11.
[44] Maury Klein, *The Life and Legend of Jay Gould* (Johns Hopkins University Press 1986) 99–115.
[45] Charles Henry Taylor, *History of the Board of Trade of the City of Chicago* (Chicago, R.O. Law 1917) 945–48, 963–69.
[46] Paul Sarnoff, *Jesse Livermore: Speculator-King* (Investors' Press 1985) 77.

that many investors quickly made up their minds to buy cotton in order to compete with him. Livermore had bought one hundred and twenty bales of cotton in 1908, thus making huge profits.[47] On the other hand, Pattern also experienced great losses in the market.[48]

There were many other individuals who attempted to be manipulators such as Livermore. These included Crazy Harner, Benjamin Hutchinson and King Lack.[49] They claimed in daily newspapers to be great heroes in terms of the wheat market. Their speculations led to great dislike and anger in the majority of the population. Nonetheless, the ongoing struggle to implement centralized controls over futures trading in the late 1800s and the turn of the century was unsuccessful.[50]

The effort to implement the Sherman Antitrust Act (that would have applied to trading in commodity futures) was one of various unsuccessful attempts. Others included the 'Hatch Act', which passed through the two houses but was unsuccessful in the Conference Committee.[51] In addition, Theodore Roosevelt attempted to control 'dumpy' sales, which upset the market. He stated that there should be organized methods of preventing unsophisticated forms of betting in securities and merchandise.[52] In this case 'unsophisticated forms' could be actions such as making sales above and beyond that which an individual actually owned, and restricting the market. Over thirty bills were presented as a reaction to this governmental message. None, however, were implemented.[53]

Although the proposed move against manipulation failed on the issue of intention, objective indicia of intent do exist. Some types of behaviour are likely to be associated with manipulative purposes in the proposed definition. A directing principle in identifying such behaviour is that rational investors usually attempt to buy as inexpensively as they can and sell as high as they are able to. Therefore, a dealer who buys for more, or sells for less, than that which was required to execute the transaction, is most likely to be acting for the purpose of manipulating price, rather than as an investor or opportunist. This type of uneconomic behaviour

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[47] ibid 46–47.
[48] Ibid.
[49] Taylor (n 45) 503–04.
[50] Kendall (n 43) 105–06.
[51] *Board of Trade v United States,* 246 US 231 (1918); *United States v Patten,* 226 US 525 (1913).
[52] Cong Rec 1349 (31 January 1908).
[53] Cong Rec 1403 (26 January 1909).

demonstrates itself in a number of practices, all of which are designed to emphasize the impact of price in any business, or chain of businesses. Practices of this nature are plainly detrimental, in the sense that they knock out of the market other competitors and, in the long term, reduce market diversity and options for the consumer.

Generally, traders achieve this cost impact by the manner in which they place their orders. As noted previously, all operations have some effect on price, and this is mainly true with large-scale businesses. Thus, any effort to buy a large quantity of a product will tend to force its price up. The rational dealer will seek to reduce the price impact of his own trades, since this will allow him to achieve the best value. When trades are effected in a manner that appears intended to heighten the price impact, manipulative intention may be suspected.

4.5 The Definition of Market Manipulation

No entirely satisfactory definition of market manipulation is yet available, in either the legal or economics literatures.[54] However, numerous attempts at definitions related to regulatory, judicial and scholarly aspects exist. *Cargill Inc v Hardin*,[55] a 1971 US case, provides a classic definition of market manipulation; any activity or scheme that has a deliberate influence on the price of a financial investment, leading to a varied price other than that which would have resulted in the absence of such an intervention.[56] According to the Securities and Exchange Act of 1934, manipulation is: 'broadly defined as the effecting of changes in security prices by means of artificial stimuli, as opposed to the normal changes that occur in the free market subject only to the interplay of supply and demand'.[57] According to the former president of the New York Cotton Exchange, A Marsh, manipulation is 'any and every operation or transaction or practice, the purpose of which is not primarily to facilitate the movement of commodity at prices freely responsive to the forces of supply and demand; but on the contrary, is calculated to produce a price distortion of

[54] Emilios Avgouleas, *The Mechanics And Regulation Of Market Abuse* (Oxford University Press 2005); Rebecca Soderstrom, 'Regulation Market Manipulation: An Approach to Designing Regulatory Principles' (2011) *Uppsala University:* Working Paper 1.
[55] *Cargill Inc v Hardin*, 452 F2d 1154 (1971).
[56] Soderstrom (n 14).
[57] Avgouleas (n 54).

any kind in the market.'[58] All these definitions point to the fact that market participants are somehow fooled with the occurrence of market manipulation.[59]

The detailed definition of market manipulation affirms that it is characterized by four elements, namely:

i) the commission of a manipulative act or omission; ii) the intent to commit such an act or omission; iii) causation; iv) artificial pricing.

In economic terms, the concept involves the unfair transfer of market benefits and wealth from a large number of market players to a very small number of players through unfair means by the latter.[60] Manipulation distorts the value, demand or supply of a financial instrument.[61] The central aim of manipulation is distortion of the market price structure, leading to an artificial price of the financial instruments in the markets. Several of the factors that enhance market manipulation include rapid growth, involvement of inexperienced investors and lack of effective regulations.[62] Some of the market manipulation strategies include wash sales (used to create the impression that certain securities are being traded more actively than is really the case), the use of matched orders (involved in a transaction related to the sale or purchase of the security with prior knowledge that a matching transaction would be entered by an associate at the same time, size or price), formation of pools (groups of people that come together with a goal of rigging the market), making an issue 'hot', warehousing, parking and boiler room operations (deceptive practices that involve the purchase of commodities whereby all or most of the investor's money is stolen).[63]

[58] ibid 106.
[59] Soderstrom (n 14).
[60] Columbia Law Review Association, 'Illegality of Stock Market Manipulation' (1934) 34(3) Columbia Law Review 500–02.
[61] Craig Pirrong, 'Energy Market Manipulation: Definition, Diagnosis, and Deterrence' (2010) 31(1) Energy Law Journal 1, 3–4.
[62] Landis Konecny, *Stocks and Exchange* (BoD 2012) 197.
[63] Daniel R Fischel and David J Ross, 'Should the Law Prohibit "Manipulation" in Financial Markets?' (1991) 105(2) Harvard Law Review 503, 507; Matthis Nelemans, 'Redefining Trade-Based Market Manipulation' (2008) 42(4) Valparaiso University Law Review 1169, 1175; Pirrong (n61) 3–5.

4.6 The Dangers of Market Manipulation

Perhaps the recent LIBOR scandal is the most appropriate place to start with anecdotal evidence of the dangers of artificially tinkering with the international market. Whilst not technically a manipulation of securities, the wide impacts of LIBOR rate-rigging have led to criminal convictions being mooted, a corporate blood bath and the financial health of many institutions being hit hard by the ripple effect of the self-serving practice.[64] Furthermore, the reputational loss that occurs to some institutions can sometimes be the hardest damage to repair; distrust of an entire industry where the complexities and intricacies of operation are guarded from the layperson can be difficult to remedy.[65]

In a similar vein, market manipulation can have a widespread and damaging impact on the securities market. Market manipulation, where the market is effectively *controlled* by manipulative parties as opposed to the natural forces of the market, makes markets much less predictable, and this is a risk that investors are and will become increasingly aware of.[66] Furthermore, the presence of this self-serving desire, coupled with a complete lack of transparency, has significant reputational impacts on a market, as its credibility is called into question by bona fide investors concerned about the security of their investments.[67]

Furthermore, market manipulation and the control it has can be uncomfortably felt from the manner in which natural market competition is distorted; giving such a false advantage or disadvantage can have a detrimental impact on the honest players within the market arena.[68]

Evidently, this type of practice, which is for the benefit of a minority at the expense of the majority, is financially, socially and politically unattractive and can have incredibly damaging connotations all around; it is for this reason that several jurisdictions have enacted legislation in an attempt to try to stop such manipulative

[64] Justin O'Brien and Olivia Dixon, 'The Common Link in Failures and Scandals at the World's Leading Banks' (2013) 36 Seattle University Law Review 941, 941–43.
[65] ibid 942.
[66] Stephen C Pirrong, *The Economics, Law, and Public Policy of Market Power Manipulation* (Kluwer Academic Publishers 1996) 124–25.
[67] Satyajit Das, *Extreme Money: Masters of the Universe and the Cult of Risk* (1st edn Financial Times Prentice Hall 2011) 259.
[68] Joseph E Stiglitz and José Antonio Ocampo, *Capital Market Liberalization and Development* (Oxford University Press 2008) 299–300.

practices from being successful with both penal and deterring tools. A number of these enactments are considered below.

4.7 Types of Manipulative Conduct and Deceptive Practices

4.7.1 Concepts of Manipulative Practices

4.7.1.1 Wash Sales

Manipulative devices are applied in averting or changing the natural advancement of the values of the security markets.[69] Such practices are in conflict with legal provisions in both the United States and the United Kingdom that stipulate that financial markets should be permitted to operate freely markets and without any fraudulent activity.[70] There are many trading activities that are associated with market manipulation practices. The activities are normally defined in relation to their potential to generate profits to those who practise them.[71] For instance, wash sales are used to a false impression that certain securities are actively being traded.[72] However, those that trade upon them do not realize that there has been no change in ownership. This is because the manipulator induces others to buy, acquiring the securities and selling them within a short period of time; there is a transfer in the beneficial ownership. The fraudsters achieve their goal by placing an order to sell the securities with one broker while placing another order to purchase the same number of securities with another broker. This implies that manipulators must deal in a variety of securities at the same time to ensure that they effectively achieve a wash sale. These perpetrators also use false accounts in a bid to conceal the actual ownership of the embezzled securities.[73]

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[69] *Ernts and Ernts v.Hochfelder*, 425 US 185 [1976] 197–201.
[70] Louis Loss and Joel Seligman, *Fundamentals of Securities Legislation* (Aspen Publishers Online 2004) 930–34.
[71] Avgouleas (n50) 105.
[72] Rajesh K Aggarwal and Guojun Wu, ‘Stock Market Manipulation: Theory and Evidence’ (2003 University of Michigan) Working Paper 1.
[73] ibid.

4.7.1.2 Matched Orders

The use of matched orders is another form of manipulative practice.[74] Use of matched orders occurs when an individual is involved in a transaction related to the sale or purchase of the security with prior knowledge that a matching transaction would be entered by an associate at the same time, size or price. The two parties normally hide their identities from the market by involving an unsuspecting third party, usually brokers.[75]

4.7.1.3 Pools

Another form of manipulative conduct is the formation of pools.[76] A pool consists of a group of people that come together with the goal of rigging the market. Their objective is normally to stimulate or depress the security market for the generation of profits to the pool members.[77] The pools as described as either ‘bull’ or ‘bear’ in nature. The *bull* pool aims to raise the price of the security in order to make profits to the members. The members are required to initially acquire options to the security. This is the stage when the pool reduces the prices of a security by encouraging sales; however, the purchases will still be higher in a bid to support accumulation. The pool will endeavour to bring about an appreciation in the value of a particular security once it has strategically established itself in the market for that security. The pool formation may later decide to trade although such actions will be accompanied by false speculations on the stock forecast to lure security buyers. This leads to an increase in the price of the security. Such falsehoods on the stock forecast are normally orchestrated through the press, with strategic placement of tips and information directly or through the involvement of brokers. The increase in the price of the securities enables the pool to float their securities in the market. The members are supposed to look for options and sell their stock at a profit. However, they do not sell all their stock at once, due to the fact that intense selling might depress the price

[74] James Mathias, ‘Manipulative Practices and the Securities Exchange Act’ (1936–1937) 3 University of Pittsburgh Law Review 7.
[75] ibid.
[76] Christopher Branda, 'Manipulation Of The Stock Markets Under The Securities Laws' (1951) 99. University of Pennsylvania Law Review 659; Adolf Berle, ‘Stock Market Manipulation’ (1938) 38(3) *Columbia Law Review* 393.
[77] Eugene Rostow, ‘Market Manipulation and the Securities Exchange Act' (1937) 46(4) Yale Law Journal 624.

of the stock. Therefore, the pool stabilizes the market through purchases, although the stock sales should always be maintained at a higher price than the purchases.[78]

'Bear pools' are fraudulent formations that are applied by the manipulators who seek to purchase securities at a price lower than the prevailing market price.[79] They apply artificial means to suppress the security prices. In this case, pool members do not accumulate securities; they sell their securities and then buy them at reduced prices in order to make a profit. Initially, the pool members sell more securities than they purchase. This will then be followed by the deployment of false speculation to drive down the prices of the shares which have already been sold. The purchases commence once the prices of the shares are lowered.

Another common form of security manipulation is the combined use of short sales and corners techniques. Use of corners occurs when a group of traders withhold the supply of an investment, requiring investors to adhere to the market demands that are normally at the trader's advantage. The capital issued by the traders for this strategy is supposed to be small, to ensure that the short sellers are few.[80]

4.7.1.4 Short Sales

Short sales involve the traders selling securities that they do not own out right. The investor would be short of stock if the broker were to execute the order. The short seller would effect the sale through the anticipation of a fall in the price of the security, with the aim of making a profit by buying the same number of shares at a lower price. This will result in the broker to borrowing the required shares, which could be from another broker. The demand for the stock can also be manipulated by underwriters through making an issue 'hot'. This can be achieved through spreading misrepresentations on the market stock or purchasing the stock to give an appearance of market activity related to the stock.[81] Manipulation of prices through the 'hot issue' strategy can be achieved through deliberately fixing a low initial offering

[78] Branda (n76) 659; Columbia Law Review Association (n60) 500, 501–02.
[79] Alan Palmiter, *Securities Regulation: Examples and Explanations* (Aspen Publishers Online 2008) 313.
[80] Paul L Porterfield, 'Securities: Stock Market Manipulation at Common Law and under Recent Federal Securities Legislation' (1940) 28(3) California Law Review 378, 379–80.
[81] Lewis Lowenfels and Alan Bromberg, 'Securities Market Manipulations: An Examination and Analysis of Domination and Control, Front-Running and Parking' (1991) 55 Albany Law Review 293, 342.

price, delaying informing the concerned parties of their allotments, denying the allottees certificates, to prevent them from disposing of their securities, discouraging customers from selling the securities and allotting their securities to the firms trading on an over-the-counter basis to motivate them to attract more market.[82]

4.7.1.5 Warehousing Practices

Securities can also be manipulated by 'warehousing practices' that allow the broker-dealers to limit the flotation of certain securities as long as they are willing to benefit themselves or benefit the insiders in the company.[83] Such securities are held in anticipation that they will attain a premium rate after the official launch of the informal agreement. The manipulator and the associates agree to hold some shares for selling when the prices stabilize. However, the instigators do not engage in any form of speculation in this case. Contrary to the case of wash sales, the beneficial ownership of the securities is a closely guarded secret, hidden in a third party account. The control of security is effectively conducted in the distribution stage. The shares are warehoused or parked and allotted to purchasers who undertake to dispose them only after sometime. The underwriter may also allocate most of the securities in the accounts over which they have control or authority. The underwriter can also issue the stocks to other favoured accounts or to those of their affiliates.[84]

4.7.1.6 Parking

Parking refers to the selling of stocks in anticipation that the seller will reclaim ownership in the future, provided that the true ownership of the stock is concealed.[85] In this case, the seller is faced with the risk of economic bargain. Parking is different from warehousing; it refers to the purchase of the stock by one person on behalf of another person. For instance, a broker may be instructed by a bidder to purchase stock for them and transfer the stock once the bid is announced. The interplay of reasons such as the avoidance of reporting requirements, net capital and margin rules

[82] ibid; Branda (n75) 659–-62; Porterfield (n 80) 379–80.
[83] Vivien Goldwasser, 'Regulating Manipulation in Securities Markets: Historical Perspectives and Policy Rationales' (1999) 5 (2) Australian Journal of Legal History 149.
[84] Douglas Cumming and others, 'Exchange Trading Rules and Stock Market Liquidity' (2011) 99(3) Journal of Financial Economics 654.
[85] Lowenfels and Blomberg (n 81) 337.

may negate the manipulative tendency of the parking in the creation of an artificial market. However, it is normally adopted as part of a larger scheme to manipulate markets. Such a strategy was applied by the defendants in the *Guinness* and *Blue Arrow* cases in misleading the market and hiding the fact that the *Guinness and Blue Arrow* had been unsuccessful.[86] Parking can also be applied by an underwriter to restrict the supply of stock to curb depression of the market following speculations.[87] The stock is later floated at a constant price and bid at a higher price with the commencement of trading. Underwriters can enhance speculation by parking stocks in bogus accounts as part of the preliminary distribution, and later selling the stocks in the market once the price stabilizes.[88]

Market manipulation can also take the form of runs. This entails a group of people participating in a concentrated buying of securities while simultaneously spreading true or false rumours that lead to an abrupt and significant rise in the price of the securities. The people responsible for changes in the market activity will float their holdings at an agreed profit once the price of the shares appreciates. The various manipulative strategies applied to the security markets are bound to grow in the presence of factors such as rapid growth, involvement of inexperienced investors and lack of effective regulations.

4.7.1.7 Boiler Room Operations

There are other types of manipulative conduct that are directly linked to market activities. One of them is high-pressure ‘boiler room’ operations.[89] These are deceptive practices that involve the putative purchase of commodities, whereby all or most of the investor’s money is stolen. The investors take the bait of the unscrupulous conmen claiming to operate legitimate commodity trading corporations. Such conmen resort to many measures, such as high commissions and misrepresentation, to ensure that the investors do not gain from their investments in commodity futures, and do not obtain refunds. It is relatively more difficult to detect a commodity fraud than a security scam. If a boiler room operation involves the sale

[86] Avgouleas (n 50) 114.
[87] Lowenfels and Blomberg (n 81) 337–39.
[88] ibid.
[89] David Cielusniak, ‘You Cannot Fight What You Cannot See: Securities Regulation on the Internet’ (1998) 22(2) Fordham International Law Journal 612, 613.

of shares, the victim detects the fraud when the shares are not delivered. However, in the case of commodities, the victim can only detect fraud after the delivery time has passed; normally six months after the sale has been made. Such con-companies may also play on the strategem of delayed deliveries as a ruse to gain further clients.

4.7.1.8 Modern Pressures – Technology

The introduction of this section made it clear that market manipulation is by no means a new phenomenon; traders have in fact been manipulating markets and the associated securities for many years.[90] However, two changes or advances have made it both simultaneously more difficult and easier (as paradoxical as that may initially sound) for market manipulators to achieve their goals; these two elements are the growth in size of the market and the phenomenal advances in technology.[91]

To deal first with technology: a recent media article revealed that chatroom-style software, which has grown exponentially in popularity both as a social tool and marketing powerhouse, has become a major problem to markets and regulatory bodies seeking to deal curb manipulative practices.[92] The problem that arises from chatroom-style communication originates from the speed at which messages can be transferred between participants within the conversation; the almost instantaneous transfer of message means manipulators can communicate with each other on a live stream with regard to their manipulative practices.[93] As was noted above, many of the market manipulation practices that are used by manipulators rely heavily on 'matched trading' in the sense that transactions of selling and buying are conducted within a short interval of one another to create an illusion of high-volume and high-frequency trading when this may not be the case. Instant messaging platforms in the

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[90] See section 2.2.

[91] David C Donald, 'Regulating Market Manipulation Through an Understanding of Price Creation', National Taiwan University Law Review (28 August 2010) 1, 10–12, 27 <http://www.researchgate.net/publication/228151370_Regulating_Market_Manipulation_Through_an_Understanding_of_Price_Creation> accessed 14 September 2015; Rosa M Abrantes-Metz, Gabriel V Rauterberg and Andrew Verstein, 'Revolution In Manipulation Law: The New CFTC Rules And The Urgent Need For Economic And Empirical Analyses' (2013) 15(2) University of Pennsylvania Journal of Business Law 357, 391.

[92] Jenny Strasburg, 'Big Banks May Block Traders from Chat Rooms' (*WSJ*, 11 November 2013) <http://online.wsj.com/news/articles/SB10001424052702304868404579189861293808726> accessed 11 November 2015.

[93] ibid.

form of social media platforms provide the perfect forum for such transactions to be executed.

Despite the revelations of the LIBOR scandal, where it was claimed that the manipulative practices of a group, albeit a large group, of market traders was not known of within the upper tiers of the institutions involved, the current practices have both concerned and riled certain high-profile institutions such as J P Morgan, which are considering blocking such facilities amidst the regulatory concerns.[94]

The second matter is the size of the market. Notably, it is inherent that the developing markets, which are newer, smaller and hence much less sophisticated than the US and UK markets, are more prone to market manipulation,[95] as a few agents within the market are able to exercise the majority of the control and power.[96] This does not mean that the larger and more sophisticated markets have become immune to the problem by their exponential growth;[97] the misuse of the market is not limited to the smaller markets, as the discourse both above and below this point shows, market manipulation, both historically and in present times, has played a vast role in the context of developed economics and the only real difference can be in the sophistication or characteristics of a typical manipulation transaction.

The regulation of financial markets was initiated to remedy the widespread violations of investors' trust due to the deceitful and meaningless disclosures of companies in the early part of the twentieth century.[98] The 1929 Stock Market Crash and the subsequent Great Depression galvanized Congress into actively seeking to prevent scheming practices from infesting the marketplace.[99] The American government has for a long time recognized the problems linked to such practices, first taking the initiative to act accordingly through legislation in the form of the Securities Act of 1933 ('SA') and the Securities and Exchange Act of 1934

[94] Darrell Duffie and Jeremy C Stein, 'Reforming LIBOR And Other Financial-Market Benchmarks' (2015) 29 (2) Journal of Economic Perspectives 191.
[95] Emelio Barucci, *Financial Markets Theory: Equilibrium, Efficiency and Information* (Springer 2003) 383–385.
[96] Ralph Chami and others, *A Framework for Financial Market Development* (International Monetary Fund 2009) 11.
[97] ibid.
[98] Avgouleas (n 50) 174–75.
[99] Hearings before Committee on Banking and Currency on S Res 84 (1931) 73d Cong, 1st Sess.

(‘SEA’).[100] The specific sections of these statutes are section 17 of the SA and section 21 of the SEA.[101]

Nonetheless, there has been a focus of concern on the consequences that institutional investors such as pension and mutual funds, as well as insurance companies, have had in terms of creating undesirable distortions and fluctuations in the market price of securities particularly in the recent past.[102] These problems are further heightened by the increased vagueness in the distinction between what is deemed manipulative or legitimate in practice.[103] The problem is made explicit in the context where security dealers and other participating people in a public offering or allotment of securities concurrently bid for or buy the same security, or in the case of corporations, influence the price of their shares by buying them in the open market. In such situations, the American courts have often been noted as adopting a flexible approach in terms of the enquiry conducted to determine the nature of the transactions. In view of this, factors such as volume, timing of transactions, and trading by multiple brokers are all taken into account in the quest to determine if those involved did indeed execute illegal transactions, or whether they acted within the legal jurisdiction.[104]

Additionally, the courts have moved away from enforcement against those accused of having controlled or directed the market activity. This is justified by the argument that SEA was not intended to impose liability on bulk or block orders even in the event that they affected the market value of a security.[105] As such, it can be deduced that any liability under the SEA will accrue only when such block orders are merged to other factors, such as *scienter* the intention to deceive or defraud. *Scienter* transforms the block orders from being acceptable or within the ambit of legal practice, to being illegal or manipulative.[106] Consequently section 9(a)1 SEA generally details those activities that can be recognized as matched orders or wash

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[100] Securities Act 1933 & Securities and Exchange Act of 1934. See: A. A. Berle, 'Stock Market Manipulation' (1938) 38 Columbia Law Review 393, 397–399.
[101] See: Rules and Regulations for the Securities and Exchange Commission and Major Securities Laws, Securities Exchange Act of 1934, Pt 240.
[102] *US v Mulheren*, 938 F2d 364.
[103] Martin Rogoff, ‘Legal Regulation of Over-the-Counter Market Manipulation: Critique and Proposal’ (1976) 28 Maine Law Review 149, 160–65.
[104] Arnold S Jacobs, ‘Regulation of Manipulation by SEC Rule 10b-5’ (1973) 18 New York Law Forum 511, 513.
[105] Lowenfels and Bromberg (n 81) 309.
[106] ibid.

sales.[107] Essentially, this section prohibits any individual from engaging in specific types of conduct conducive to the creation of false or misleading appearances of active trading in any National Securities Exchange registered security.[108] It further prohibits the use of a deceptive appearance in relation to the market for any security identified as such. As a result it will be deemed unlawful if a person or persons effect any transaction whereby beneficial ownership does not change. It will also be deemed unlawful if an individual or individuals enter into a sale or buy securities with foreknowledge that an order similarly sized, similarly priced and placed at approximately the same time has been or will be placed by the same or different parties.[109]

It is pertinent to note here that while some broker-dealers will be trapped under this section of the SEA, they may not be acting in a manipulative essence *per se.* An assumption of the intent to defraud can however only be made if it can be evidenced by either the defendants' actions or from undisputable evidence connecting the defendant with the allegedly manipulative activities.[110]

Despite there being very few defences that can be utilized in the justification of such offences committed under section 9 SEA, the most acceptable approach is the use of customary practice. As a result, if the accused person or firm can prove that they were acting on the instructions of another, they will outrightly be deemed innocent by the court in relation to committing an offence as per the section 9 SEA. This is so because the beneficial ownership in the securities passes from one side to the other.[111]

Nonetheless, a manipulative practice may be considered if the individual is proved to have accessed the discretionary company accounts while conducting the said transaction. Section 9(a)2 SEA only covers those transactions that are deemed to be manipulative by nature, thereby meaning that a number of individuals are involved in the creation of a bull or bear effect on the securities market for their own

[107] Rules and Regulations for the Securities and Exchange Commission and Major Securities Laws, Securities Exchange Act of 1934, Pt 240; Lowenfels, Lewis D, 'Sections 9(a)(1) and 9(a)(2) of the Securities-Exchange Act of 1934 - an Analysis of Two Important anti-Manipulative Provisions Under the Federal Securities-Laws' (1991) 85 (3) North western University Law Review 698-699.
[108] ibid.
[109] Lowenfels (n107) 703.
[110] *Harold T. White* (White, Francis M. Weld), 3 SEC (1938) 466, 510.
[111] Section 9 of the 1934 Act.

advantage.[112] Therefore, it is illegal for any individual to facilitate a series of transactions in any security which includes: creating actual or apparent active security[113] and also depressing or raising the price with the intent of inducing the purchase or sale of the identified security by others. Section 9 SEA further covers a broad variety of other manipulative practices, such as circulation or dissemination of false information.[114] The making of a misleading or false statement in relation to the price of a specific security are among those practices addressed in the section.[115]

Moreover, the courts deem it sufficient evidence of knowledge of the scheme to attract liability, there being no need to prove the existence of a special relationship between the concerned parties. Section 10(b) SEA can be described as a catch all provision precisely because it is designed to deal with those abuses that escape the other prohibitions set out in sections 9 and 10(a).[116] Additionally, section 10(b) makes it illegal for individuals to use mail or interstate facilities of commerce in the quest to influence the purchase or sale of any identified security.[117] Any deceitful or manipulative device or other contravention of rules and regulations prescribed by the SEC as necessary for the protection of public interests or investors is consequently prohibited. It is implicit to note that section 10(b) makes nothing illegal unless the SEC has an adopted a rule prohibiting such an act.[118] To this end, this section is the basis for the promulgation of rule 10b-5.[119] The rule is essentially viewed as providing the basis of all the anti-fraud provisions utilized in the United States and is subsequently defined below.

For the past sixty or so years since its adoption, this simple rule has been called upon in numerous SEC and confidential proceedings. In addition, it has been applied in almost every plausible kind of situation. It has generated a redoubtable outpouring in relation to legal scholarship, including the production of over seventy leading books as well as innumerable law review articles. In the 1970s and 1980s several federal and appellate courts as well as district courts designed expansive

[112] HC Lee, 'Market Manipulation in the US and UK: Pt 2' (1993) 14 The Company Lawyer; Lowenfels (n107) 706.
[113] *US v Stein*, 456 F2d, 850 (1977) (2nd Cir).
[114] SEA, s 9(2)4.
[115] SEA, s 9(2)6.
[116] Geoffrey Poitras, *Handbook of Research on Stock Market Globalization* (Edward Elgar 2012) 287.
[117] Lewis D. Solomon, 'Securities Professionals and Rule 10b-5: Legal Standards, Industry Practices, Preventative Guidelines and Proposals for Reform' (1975) 43(4) Fordham Law Review 505, 509.
[118] ibid 280–87.
[119] ibid.

interpretations of rule 10b-5, together with other anti-fraud provisions.[120] In essence they applied the rule to impose liability for negligent and deliberate misinterpretations for breaches of fiduciary duties by corporate management. It also imposed liability on the failure of directors, accountants, lawyers and underwriters to prevent such wrongdoings to others.[121]

In the context of confidential actions for damages, the courts were willing to imply a confidential right of action in anyone whose losses were even slightly connected to the alleged wrongdoing. This was further extended to individuals who had suffered no loss, provided that the suit would help in encouraging compliance of the law.[122] This development was further abetted and aided by the Supreme Court by virtue of adding or giving an expansive scope to the terms 'purchase or sale', ' fraud' and the 'connection' that had to link them.[123] This was however reversed by a new conservative majority in 1975 whereby in a series of decisions the Supreme Court gave a narrow definition to the terms associated to rule 10b-5 and other provisions for anti-fraud.[124] This limited the situations or contexts within which the private or confidential right of action could be legally implied. The tone of these Supreme Court decisions cast doubt on the validity of several of the expansive decisions in the previous years, as well as those that have not yet been specifically overruled precisely because they are deemed more significant in their actual holdings. Despite there being no logical arrangement of order there are generally three separate clauses in rule 10b-5:[125]

- clause (2) speaks in terms of misstatements or missions
- clauses (1) and (3) speak in terms of 'deceit' and 'fraud'.

[120] Multer, MK, 'Open-Market Manipulation Under SEC Rule 10b-5 and its Analogues: Inappropriate Distinctions, Judicial Disagreement and Case Study: Ferc's Anti-Manipulation Rule' (2011) 39(2) Securities Regulation Law Journal 97, 97-98.
[121] Section 10b-5 of the 1934 Act; Lowenfels (n107) 705.
[122] Marshall, W. Taylor, 'Securities law - the Securities Exchange Act of 1934 - 'round and 'round we go: the Supreme Court again limits the circumstances in which federal courts may hold secondary actors liable under section 10 and SEC Rule 10B-5 ' (2008) 1, University of Arkansas at Little Rock Law Review 196-197.
[123] Steve Thel, 'The Original Conception of Section 10(b) of the Securities Exchange Act' (1990) 42(2) Stanford Law Review 385, 386-387.
[124] ibid 197-198; Norman S. Poser, 'Stock market manipulation and corporate control transactions' (1986) 40 (3) University of Miami Law Review 671, 679.
[125] Thomas Lee Hazen, 'The Jurisprudence of SEC Rule 10b-5' (Securities Law for Nonsecurities Lawyers, San Diego, 2005).

Generally, it is assumed that clause (3), which forbids any act, practice or course of business in which it operates or would operate, has the broadest scope. It covers three aspects: (a) a fraud or deceit (b) upon any reason and (c) in connection with the purchase or even sale of identified security.[126]

The aforementioned elements in formulation further give rise to interpretative questions. Presently, unless shown to have acted with *scienter* under the rulings of Supreme Court, no person can be found to have violated rule 10b-5, either context of SEC or private action. This was firmly exemplified in the case of *Ernst and Ernst v Hochfelder* whereby the American Supreme Court cited that manipulation included:[127] 'Intentional and wilful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of Securities.' In view of this, in some courts, the *scienter* requirement does not necessarily require the individual to have acted intentionally or wilfully, but rather for it to be shown that he/she acted recklessly.

The courts have however adopted a flexible approach in the quest to identify *scienter*.[128] As such, in the context where the manipulator has avoided a loss or made a gain through such activities, the courts have readily acted against them,[129] even though it has also been noted that this lacks limitations. It is however interesting to note that the Supreme Court holds that violation of clauses (2) and (3) of section 17(a) SA (for which the language of the corresponding clauses of rule 10b-5 was adopted) can be launched without showing scienter.[130] To this end, it can be argued that the language of clauses (2) and (3) of rule 10b-5, which is based on section 10(b) SEA, has a different meaning when compared to the corresponding language in section 17(a) SA.[131] This is where the SEC's rulemaking power under section 10(b) is effected.[132]

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[126] ibid.

[127] *Ernst and Ernst v Hochfelder*, 425 US 185 (1976); Norman S. Poser, 'Stock market manipulation and corporate control transactions' (1986) 40 (3) University of Miami Law Review 671, 674.

[128] Committee on Business and Corporate Litigation, *Annual Review of Business and Corporate Litigation*, (American Bar Association 2006) 456.

[129] ibid.

[130] *Aaron v SEC*, 446 US 680 (1980).

[131] Marc I. Steinberg, 'Section 17(a) of the Securities Act of 1933 after Naftalin and Redington' (1979) 68(1)Georgetown Law Journal 163, 164–165.

[132] Section 10(b) of the 1934 Act.

With regard to protecting investors, it can be argued that the only individuals who are entitled to the protection of rule 10b-5 are those that are classified as investors.[133] Nevertheless, the definition has been extended in a number of ways, most significantly in the case of *Hooper v Mountain States Securities Corp,*[134] where the suit was in relation to a corporation being defrauded into issuing shares for an insufficient consideration. The defendant argued that the issuance of stock was neither a sale, nor was the corporation an investor. The court rejected both arguments holding, that the issuance was indeed a sale, while the fact that the corporation, having parted with shares that had economic value, was equated with holding the position of an investor.

Although it is contemplated that the fraud will be connected with the sale or purchase, it is also implicit to note that it must not relate to the terms involved in the transaction. In the case of *Superintendent of Insurance v Bankers Life and Causality Co*,[135] a group obtained control of an insurance company causing it to sell specific securities that it owned and further misappropriating the proceeds for their own benefit. The Supreme Court unanimously held:[136]

> [S]ince there was a sale of a security and since there was fraud that was used in connection with it then there was redress under section 10(b) that whatever might be available as a remedy under state law...

This reversed previous decisions by lower courts.

Subsequently, lower court decisions have referred to this decision, narrowly holding that the fraud needs to have infected the securities transactions itself, rather than by virtue of merely being involved in the misappropriation of the proceeds.[137] Consequently, it is argued that there is no liability when there is a substantial time gap and lack of a direct link between the sale and the claimed fraud.[138] The most significant addition of the connection with language was in the decision in *SEC v Texas Gulf Sulphur Co*.[139] In this particular case the court held that misstatements in a press release issued by a publicly held corporation which was not at that time

[133] Section 10(b)5 of the 1934 Act.
[134] *Hooper v Mountain States Securities Corp*, 282 F2d 195 (5th Cir 1960).
[135] *Superintendant of Insurance v Bankers Life and Causality Co*, 404 US 6 (1971).
[136] ibid.
[137] *SEC v Charles Zandford* 535 US 813 122 S Ct 1899 (2002).
[138] ibid.
[139] *SEC v Texas Gulf Sulphur Co*, 401 F2d 833(1968); Poser (n 124) 710.

engaged in buying or selling activities of any of its shares nevertheless violated rule 10b-5 in that the acts were made in connection with purchases and sales being made by investors in the open market.

Further, the recognition of a private right of action for fraudulent misstatements under rule 10b-5 highlights the possibility that such an action may be brought if the misstatement is proved to be covered by another more specific provision of federal law on securities. As demonstrated in the case of *SEC v National Securities Inc*,[140] the Supreme Court asserted that rule 10b-5 could apply to misstatements in substitute statements despite it being known that substitute solicitation was governed by particular SEC rules, as articulated in section 14 SEA. In another case, the court held that a suit can be pursued under rule 10b-5 while trying to recover damages gained from misstatements, thus giving rise to a particular right of action as articulated in section 11 SA.[141] Lower courts have also indicated that such suits can be brought in relation to misstatements in documents filed under the SEA.[142] Specific civil liability it is articulated in section 18,[143] whereby the most important court-imposed limitation is identified as the private litigation under rule 10b-5 such that the plaintiff is required to have been either a buyer or seller of securities during the relevant process of transaction.

A problem, however, can also transpire in calculating the damages in relation to losses sustained by market manipulation where investors have both gained profits and suffered damage as a result of the misstatements of a company and its agents.[144] It has been argued by Francis that the damages awarded to an investor for market manipulation have two fundamental roles to play – deterrence of future fraud and manipulation and compensating investors for their exact gains and losses – and the two are not mutually exclusive.[145] In Francis' view this can be achieved in a number of ways, including ensuring that gains are only offset against losses in the situation where the gains are sufficiently linked to an ongoing trading strategy.[146] Thus, by

[140] *SEC v National Securities Inc*, 393 US 453 (1969).
[141] *Smith v Bear*, 237 F.2d 79, 88 (2d Cir 1956); Victor Rosenzweig, 'Insider Liability Under 10b-5 – The Current State of the Law' (1974) 49(1) St John's Law Review 31, 32.
[142] Rozenweig v. Azurix corp ., 332 F3d 854, 871 (5th Circuit 2003).
[143] Roger Leeroy Miller and others, *Business Law* (Cengage Learning 2010) 981.
[144] Samuel Francis, 'Meet Two-Face: The Dualistic Rule 10b-5 and the Quandary of Offsetting Losses by Gains' (2009) 77 Fordham Law Review 3045.
[145] ibid 3047.
[146] ibid 3086.

ensuring both are catered for where an ongoing trading strategy can be found, the approach preferred by Francis and adopted in the case of *Rocker Management, LLC v Lernout & Hauspie Speech Products NV*[147] provides a dual facet to the damages regime.

However, further problems might be experienced, such as minority shareholders attacking a sale or controlling a block of sale, thus being able to command a premium over the current market price and hence amounting to fraud on the minority shareholders. In the case of *Birnbaum v Newport Steel Corp*,[148] one the earliest cases in relation to rule 10b-5, the court asserted that the chief purpose of its ruling was not to protect the sellers and purchasers of securities from being deceived or defrauded, because neither the minority shareholders nor the corporations had proceeded to buy or sell securities and thus had no cause of action. Subsequently, the purchaser-seller requirement for *Birnbaum* was re-established by the Supreme Court in the case of *Blue Chip Stamps v Manor Drug Stores*, where the defendants were obliged under an antitrust decree to offer the plaintiffs specific shares in a new company.[149] This was realized after the plaintiffs claimed that the defendant had indeed acted contrary to rule 10b-5 by giving a false and pessimistic portrayal of the new company in the prospectus with the major intent being to induce the plaintiff not to purchase the identified shares. Despite the facts being highly unusual, the court reached its decision refusing standing to any individual other than a seller or purchaser, on the wide policy ground that it would discourage 'vexatious litigation':

> The first of these concerns is that, in the field of federal securities laws governing disclosure of information, even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment[150].... and the second ground for fear of vexatious litigation is based on the concern that, given the generalized contours of liability, the abolition of the *Birnbaum* rule would throw open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony.[151]

[147] *Rocker Management, LLC v Lernout and Hauspie Speech Products NV*, Civil Action No 00-5965 (PGS), 2007 WL 2814653 (DNJ 24 September 2007).
[148] *Birnbaum v Newport Steel Corp*, 193 F2d 461 (1952).
[149] *Blue Chip Stamps v Manor Drug Stores* 421 US 723 (1975).
[150] *Blue Chip Stamps v Manor Drug Stores* 421 US 740 (1975).
[151] ibid 743.

Justice Rehnquist's majority view is complete with expressions of antagonism to private actions against corporate management, leading dissenting Justice Blackburn to remark:[152]

> [T]he court exhibits a preternatural solicitousness for corporate wellbeing and a seeming callousness toward the investing public quite out of keeping ...with our own tradition and the intent of the securities law.

The one significant exemption to the purchaser-seller requirement is that of an individual whose shares are automatically converted into shares of another company in the case of a merger exercised by means of deceptive statements, whereby he or she is entitled to sue as it is under rule 10b-5 as a case of forced seller.[153] It should be emphasized that the courts have continued to apply the forced seller exemption right following the Supreme Court's decision in *Blue Chip*.[154]

Perhaps the most revolutionary and transformational piece of United States legislation has been the Sarbanes-Oxley Act (SOX) of 2002.[155] This legislation was aimed at improving the quality of corporate disclosures in relation to their financial reporting and conduct of independent audits. This was to be achieved through increased civil and criminal liabilities in the context of security law violations.

Over the years it has emerged as a far-reaching regulation that imposes a higher degree of personal responsibility when compared to previous laws. Thus it is often criticized for being too restrictive.[156]

4.8 The Federal Trade Commission (FTC)

A small wheat crop coinciding with the outbreak of the First World War led to extensive apprehension.[157] Laws and regulations were implemented so as to regulate

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[152] ibid 762 (1975) (Blackmun J, dissenting).
[153] Loss and Seligman (n 70) 1044–53.
[154] ibid.
[155] Donald C. Langevoort, 'The Social Construction of Sarbanes-Oxley' (2007) 105(8) Michigan Law Review 1817–18; Jarod S. Gonzalez, 'Sox, Statutory Interpretation, and the Seventh Amendment: Sarbanes-Oxley Act Whistleblower Claims and Jury Trials' (2006) University of Pennsylvania Journal of Labor and Employment Law 25–26.
[156] Larry E Rubenstein, 'Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002' (2002-2003) 28 Journal of Corporate Law 1, 44.
[157] Jerry W Markham, 'Manipulation of Commodity Futures Prices: The Unprosecutable Crime' (1991) 8 Yale Journal on Regulation 281, 292.

the prices of foodstuffs for the period of the war.[158] In addition, the Chicago Board of Trade was required to implement emergency dealings, which helped to put an end to all wheat transactions in the aforementioned May wheat deals.[159]

President Wilson ratified the ban to control trade on exchanges. The Food Administration Grain Corporation was formed by President Wilson, together with the Commerce Secretary, Herbert Hoover, assisted by implementing laws and regulations.[160] This corporation mainly bought grain, while at the same time banning trade of such grains for the duration of the war.[161] The speculation at the beginning of the war led to the Federal Trade Commission (FTC) learning a great deal about all transactions related to grains.[162] The FTC carried out a widespread enquiry into the problem of management in the commodity futures markets. The FTC mainly focused on a perilous era in futures trading while contracts were deceasing and future values merging into money market prices.[163]

At this point there was a great risk of price misrepresentation, due to the fact that only specified grades of commodities held in approved exchange warehouses could be used for delivery. There are higher chances of squeezing and cornering activities by traders on occasions where there is a deficiency of grain that satisfies those provisions. It also occurs in situations where deliveries cannot be conveyed rapidly into the market.[164] Moreover, cornering activities could be halted if recognized early in the process. This was done by rushing huge amounts of grain to Chicago so as to alter its effectiveness. This was almost impossible, due to the fact that most of the cornering activities took place late in the supply month. Specifically, a squeeze can be taken as a deliberate corner that fails to be accomplished.[165]

In such cases, the market will accumulate large amounts of grain, yet the demand in that particular location will be low. More farmers will be hurrying to sell their grain in this market as a result of the desirable prices. On the other hand, other locations will have a higher demand for such grains, but are blocked in the market. By acting

[158] Kendall (n43) 134.
[159] ibid 79.
[160] Markham (n159); Jon D. Hanson and Douglas A. Kysar, 'Taking Behavioralism Seriously: Some Evidence of Market Manipulation' (1999) 112(7) Harvard Law Review 1420, 1451.
[161] ibid.
[162] Federal Trade Commission, *Report on the Grain Trade* (1921) 260, 382 (hereinafter 'FTC Study').
[163] ibid 242.
[164] ibid 322.
[165] ibid 323.

this way, farmers are attempting to offset the corner and also to maximize the profit from the grain due to favourable prices.[166]

An act of manipulation cannot be attested in the majority of occasions, and is not always existent as it is hard to tell who carried out a manipulative act. The main aim of the FTC research was to understand the main function of intent in manipulation. It was observed that the main concern of the public about this involved the person who did the manipulation. It was also noted that there were shifts in prices in the market. High prices could be as a result of financial stability and the stubbornness of the wealthy in the city, ready to spend huge amount of money in bulk-buying. Such individuals do this even when there are no plans or intentions to attain a monopolistic market in the economy.

The first rule of the Chicago Board of Trade was implemented in 1869 and 1870; a further rule was implemented in 1921.[167] Such rules were intended to prevent cornering and squeezing from taking place. However, many such cases still remained in Chicago, despite the various rules and regulations put in place to regulate trade. In addition, the study found that even during wartime (where regulations and rules were put in place) cases of squeezing and cornering were still experienced. In conclusion, the FTC demonstrated that additional rules and regulations governing trade in Chicago would play a crucial role in preventing both cornering and squeezing.[168]

In 1918, the trading of oat futures contracts was very successful. It was observed that controlling the freedom of speculators in the market played a crucial role in reducing various inefficiencies that come with speculation.[169] It was argument that government should therefore formulate rules to govern future grain trading in the market-mainly because hedging organizations manage payments for future markets. Cornering was considered a crime, and anyone committing it would be punished according to the law. Traders were not permitted to control the market by buying large amount of goods and so flooding it. Common law, according to the FTC Study, was the more appropriate means of control in such cases, as it required no evidence of any plans. In addition, the study recognized that the Sherman Antitrust Act had

166 ibid.
167 Markham (n159) 297.
168 ibid.
169 ibid.

played a crucial role in the regulation of the market, even though it was not successful. It was difficult to identify treacherous intentions in manipulations.[170]

4.9 The SEC's Anti-Manipulation Role after Dodd–Frank

The credit default swap loophole that was opened up by Enron was closed, not by the passage of the Commodity Futures Trading Commission (CFTC) Reauthorization Act of 2008, but by the Dodd-Frank Wall Street Reform and the Consumer Protection Act of 2010.[171] The Dodd–Frank Act began regulating the credit default swap market. A majority of swaps must now be handled through a regulated central counterpart that clarifies the exchange trade.[172] Under the Dodd–Frank Act, swap dealers and major swap participants, but not end-users, can have margin and capital requirements imposed on them by regulators.[173] Central counterpart, or clearing, houses must approve the standardized swaps.[174] The Federal Trade Commission (FTC), and the Federal Regulatory Commission (FERC) set the stage for Dodd-Frank to grow the CFTC's anti-manipulation authority to a level that rivalled SEC.[175] Dodd–Frank also combated abusive trading practices by authorizing the CFTC to deal with such matters.[176]

In order to enable the SEC to regulate security swaps and security-based swap dealers, the Dodd-Frank Act underwent federal securities law amendments, and portion of the Enron loophole was closed.[177] Under Dodd-Frank the CFTC was permitted oversee all swaps, other than security-based swaps regulated by the SEC, declaring shared jurisdiction over mixed swaps.[178] Due to the additions to its anti-

[170] 15 USC §1 (1988); ibid 297–98.
[171] Samuel Rawson Gardiner, *Report of Cases of The Star Chamber and High Commission* (Camden Society1886) 43; Charlotte Twight, 'Dodd-Frank Accretion of Power, Illusion of Reform' (2015) 20(2) Independent Review 197, 197–198; Towns, Edolphus, 'On the Dodd-Frank Act' (2011) 1 Harvard Business Law Review
[172] II The Publication of the Selden Society, Select Cases Before The King Council in the Star Chamber (AD 1509–1544) (1908) 290.
[173] *State v Duluth Board of Trade*, 121 NW 395, 403 (Minn 1909)
[174] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1st edn, Great Books 19520 1776) 229
[175] Hebert Hovenkamp, 'The Antitrust Movement and the Risk of Industrial Organizations' (1989) 68 Tex L Rev 105, 155.
[176] Section 747 of the Dodd-Frank Act.
[177] *The Mogul Steamship Ltd v McGertor, Gow & Co*, 23 QBD 598 (1889).
[178] *The King v De Berenger*, 105 Eng Rep 536 (1378–1865).

manipulation powers, the SEC was able to swap transactions that fell within its jurisdiction.[179]

To add to the SEC's increasing power, the Dodd-Frank Act authorized the SEC to adopt any rules that reasonably prevented security-based swaps from being traded fraudulently or harmed by deceptive or manipulative practices.[180] This power was to be housed under section 9 of the 1934 Act,[181] instead of section 10(b) of the same statute. It is notable that the burden of proof under section 9 is greater than that described in section 10(b).[182]

Under this provision, in 2010 the SEC proposed rule 9j-1, which incorporates section 10(b) of the Securities Exchange Act of 1934, and the prohibitions in section 17(a) of the Securities Act of 1933, into the SEC's definition of fraud and manipulation.[183] The proposed rule could apply to 'any person' and could encompass security-based swap dealers, those associated with counterparties, major security-based swap participants, and any other individuals the SEC deemed relevant.[184] The SEC asserted that the proposed rule would be universally applied, and that end-users of security-based swaps would have no exemption.[185] The rule sought to extend the power of prohibition to any exercise of right or obligation performance under a security-based swap. The nature of security-based swaps requires deliveries, ongoing payments, and collateral postings between the relevant parties. The SEC proposed to make 'explicit the liability of persons that engage in misconduct to trigger avoid or affect the value of such ongoing payments to deliveries.'[186]

The difficulty, however, with the interaction between the legislation and the judiciary is that the latter has seen fit to forcefully apply or stretch legislation and the language of the law to unknown bounds.[187] As Fischel has argued, the difficulty with the law has been that the judiciary has effectively shoe-horned secondary liability

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[179] William Laurence Saunders, *The Colonial Records Of North Carolina* (PM Hale State Printer 1886)185.
[180] Section 712 of the Dodd-Frank Act.
[181] Hovenkamp (n 179) 105, 155.
[182] Craig R. Enochs, 'Update on the Dodd-Frank Act' (2014) 36(2) Houston Journal of International Law 341, 348.
[183] *Standard Oil Company of New Jersey v United States*, 221 US 1, 55 (1910).
[184] Dan M. Berkovitz , 'Swaps provisions of Dodd-Frank Act: cost-benefit analysis and judicial review' (2014) 33(9) Banking & Financial Services Policy Report 1, 12; Enochs (n186) 343.
[185] Federal Register, Vol 75, 68562.
[186] ibid.
[187] Daniel Fischel, 'Secondary Liability Under Section 10(b) of the Securities Act 1934' (1981) 69 California Law Review 80, 111.

into the Securities Exchange Act of 1934 in circumstances where the language of the statute and the legislative history does not suggest that it was Congress's intention for such secondary liability to be imposed.[188]

Fraudulent conduct connected with security-based swaps which affect payments, deliveries, or cash flow values would also be controlled under this rule. An example of this is the obligation to trigger a counterparty to make a large deposit or offer up additional capital. A further example is the action taken to avoid triggering a larger payment or any further performance obligation related to a security-based swap.[189]

The SEC stated that prohibitions modelled according to rule 10b-5 would require proof of *scienter* in order to secure proof of a violation, while section 17(a)(2) and (a)3 of the Securities Act of 1933 requires equally strenuous conditions.[190] The SEC states that under section 17(a), violations are only required to demonstrate negligence.[191] The proposed rule differs in its language from the language used in rule 10b-5. The proposed rule includes 'manipulative' conduct, a term not in rule 10b-5 but found in section 10(b).[192]

4.10 Conclusion

It has been established that securities laws seek to penalize or regulate misleading statements, market manipulation and other activities in order to avert the damage that can be caused in relation to the orderly functioning of the wider securities market.

US law has adopted civil remedies as a mode of compensating the individuals who have suffered damage arising from abusive practice. The identified civil remedies are grounded on common law remedies, and as such they share somem of the inadequacies that are also evidenced in common law. In the United States, civil remedies are viewed as having not only a compensatory function but also a deterrent function.

US law essentially focuses on the registration process as well as the civil remedies. Among the ways in which the law seeks to limit abusive practices is through the

[188] ibid.
[189] Federal Register, Vol 75, 68563.
[190] Securities Act of 1933, s17(a)2 & s17(a)3.
[191] ibid.
[192] ibid.

requirement for issuers of securities as well as other collateral parties involved in the sale process to dutifully disclose all the material information that will in turn enable the investors to make an informed decision of whether or not to buy the securities, after scrutinizing the information that is truthfully availed to them. A regime of administrative controls, supplemented by criminal and civil liabilities is further utilized to ensure that the identified obligations are fully complied with.

Both the common law and statutory law offer shareholders a legal right to information about a company's affairs. However, this is a limited right, and is only available to shareholders. The same right is not given to an investor. The seller is required by law not to utter falsehoods or otherwise mislead with no obligation to speak. Nonetheless, statutory developments in this field were also noted to virtually render the principle of *caveat emptor* irrelevant. In relation to my work, the next chapter will explore further the law of market manipulation in the jurisdiction of the UK.

CHAPTER 5: THE UK LAW OF MARKET MANIPULATION

5.1 Introduction

The purpose of this chapter is to explore the laws relating to market abuse and manipulation that prevail within the United Kingdom. This chapter will focus on the current legal regime in this regard, while attempting to contextualize it by reference to the developments which have shaped its evolution into its current shape. Accordingly this chapter will begin by looking at the legislative framework dealing with market manipulation. In this regard the law's criminal provisions will be looked at separately from those of a regulatory nature. The role of the Tribunal in cases involving financial services will also be looked at. Since the United Kingdom is a member of the European Union, EU law's relating to market manipulation will also be examined. Next, notable incidents of market manipulation will be discussed so as to provide an idea of the challenges which the legal and regulatory mechanisms face. This will be followed by a conclusion.

5.2 The Legislative Framework in the UK

The legislative framework that addresses issues relating to market abuse and manipulation has developed over time and has undergone far-reaching changes in recent years.[1] This evolution can be attributed to various scandals within the financial services sector which have spurred successive governments on to regulate the financial markets.[2] It was due to several such scandals in the 1970s and 1980s, and the Gower Inquiry which followed them, that the Financial Services Act 1986 was passed.[3]

[1] Eilis Ferran, 'Examining The UK's Experience In Adopting The Single Financial Regulator Model' SSRN Electronic Journal 1, 2–12; Keith Pilbeam, *Finance and Financial Markets* (Palgrave Macmillan 2010) 1, 465–69.
[2] ibid. Also see: Guy Davidov and Brian Langille, Boundaries And Frontiers Of Labour Law (Hart 2006), ch 9; Ron Cowan, 'Big Bang Finding Challenged' (2014) 510 Nature,1,1.
[3] Terry Arthur and P Booth, *Does Britain Need A Financial Regulator?* (Institute of Economic Affairs 2010) 1,38-42; LCB Gower, Review Of Investor Protection (HMSO 1984) Report Pt 1, Cmnd 9125.

Prior to the passage of the 1986 Act, financial institutions had been expected to self-regulate.[4] However, although it created the Financial Services and Markets Tribunal, the 1986 Act did not completely end self-regulation, and it has been noted that the 1986 Act was weak in terms of the regulatory structure it imposed. This point appears to be one of the main reasons for its eventual repeal in 2000, when it was replaced by the Financial Services and Markets Act 2000.[5] The 2000 Act created the Financial Services Authority (FSA) which acted as the official regulatory body with regard to financial instruments and markets until its abolition following the amendments made to the 2000 Act by the Financial Services Act 2012, which *inter alia* divided the functions of the Financial Services Authority between the Bank of England, a newly created Prudential Regulation Authority, and a newly created Financial Conduct Authority.[6] In this thesis the Financial Conduct Authority (FAC) will be treated as the successor of the FSA, having inherited the FSA's role as a regulator of financial conduct.[7] For the sake of clarity it is also pertinent to mention that the Financial Services and Markets Tribunal, which was created by 1986 Act, was also abolished in 2010; its functions have been transferred to the Upper Tribunal as part of an attempt to rationalize the system of tribunals in the country.[8]

As a result of the developments in this area of law, following the financial recession of 2007-08 and the London interbank offered rate LIBOR rate-fixing scandal of 2012, it is the Financial Services and Markets Act 2000, as amended by the Financial Services Act 2012, which is the main piece of legislation governing market manipulation.[9] Even so, there are other statutes that overlap with the amended FSMA

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[4] Jan Peeters, 'Re-Regulation of the Financial Services Industry in the United Kingdom' (1988) 10 University of Pennsylvania Journal of International Business Law, 371,373; Arup Daripa, Sandeep Kapur and Stephen Wright, 'Labour's Record On Financial Regulation' (2013) 29 Oxford Review of Economic Policy 71, 76–78.

[5] Terry Arthur and P Booth, *Does Britain Need A Financial Regulator?* (Institute of Economic Affairs 2010) 1,55.

[6] Kokkinis Andreas, 'The Financial Services Act 2012: The Recent Overhaul Of The UK's Financial Regulatory Structure' (2013) 24 International Company and Commercial Law Review 325,326–28.

[7] A. Georgosouli, 'The FCA-PRA Coordination Scheme And The Challenge Of Policy Coherence' (2012) 8 Capital Markets Law Journal, 1, 62; E. Ferran, 'The Break-Up Of The Financial Services Authority' (2011) 31 Oxford Journal of Legal Studies 437, 456–59.

[8] Terry Arthur and P Booth, *Does Britain Need A Financial Regulator?* (Institute of Economic Affairs 2010) 1,58-59; Philip Rawlings, Andromachi Georgosouli and Costanza Russo, 'Regulation Of Financial Services: Aims And Methods' [2014] Queen Mary University, Centre for Commercial Law Studies, 1, 25; Stephen M Bainbridge, *Research Handbook On Insider Trading* 1, 424–25.

[9] Great Britain, *Financial Services Act 2012* (TSO 2013), 1, 2–4.; Noam Noked, 'Financial Services Act 2012: A New UK Financial Regulatory Framework' (2013) Harvard Law School Forum on

in their application to instances of market manipulation.[10] It is also worth noting that as the law currently stands, there are two types of legal provision that deal with offences relating to market abuse, namely criminal and civil regulatory provisions.[11] We shall look first at the relevant criminal provisions before turning to the latter.

5.3 Provisions of Criminal Law

5.3.1 Criminal Justice Act 1993

The principal item of criminal legislation in this area is the Criminal Justice Act 1993 (CJA 1993).[12] Part V of the statute contains the offence of 'insider dealing'.[13] This Act is not responsible for the creation of this offence, which has existed since 1980.[14] However the Act does implement the European Union's Insider Dealing Directive.[15] Section 52 of this Act provides in the relevant part as follows:[16]

> (1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.
>
> (2) An individual who has information as an insider is also guilty of insider dealing if—
>
> (a) he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or
>
> (b) he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person.

Corporate Governance and Financial Regulation <http://corpgov.law.harvard.edu/2013/03/24/financial-services-act-2012-a-new-uk-financial-regulatory-framework/> accessed 22 August 2015.

[10] ibid.

[11] Howard Chitimira, 'A Historical Overview of Market Abuse Prohibition in the United Kingdom' (2014) 5(20) Mediterranean Journal of Social Sciences 1, 53.

[12] Keith Wortherspoon, 'Inside Dealing – The New Law: Pt V Of The Criminal Justice Act 1993' (1994) 57 The Modern Law Review 333, 419.

[13] ibid; Wunmi Bewaji, *Insider Trading In Developing Jurisdictions* (Routledge 2012) 10–13.

[14] Wortherspoon (n 12) 333, 433.

[15] EU Insider Dealing Directive (89/ 592/ EEC); Kern Alexander, UK Insider Dealing and Market Abuse Law (Elgar 2013) 411–13; Marco Ventoruzzo, 'Comparing Insider Trading In The United States And In The European Union: History and Recent Developments' (2015) 11 European Company and Financial Law Review 479, 555.

[16] CJA 1993 Pt V, s 52.

> (3) The circumstances referred to above are that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary.

A bare reading of this section is sufficient to clarify that the offence in question can be committed in any of three ways. A person having inside information who deals in price-affected securities is guilty of such an offence. Such a person, who does not deal in price-affected securities but encourages another to do so, is also guilty of the offence. Lastly, a person who has insider information would be guilty of an offence under this section where he provides the information to someone else, other than in the proper course of his professional duties.[17] The definition of insider is wide enough to include individuals who receive information from another individual, such as a spouse. The Act defines inside information to be information that relates to particular securities or issuers, that has not been made public and which if made public would significantly impact on the security prices.[18] Two important points need to be made with regard to this offence. First, only individuals can be charged with this offence, and not legal entities. Furthermore, although the offence attracts a penalty of unlimited fines and/or a maximum of seven years in prison, the actual contract is not voided and the transaction based on inside information is not affected.[19]

It may also be relevant to note here that a previous incarnation of the 1993 Act, namely the Criminal Justice Act 1987, founded the Serious Fraud Office (SFO) and provided it with wide powers to investigate and proceed with legal action against critical and complex cases of fraud.[20] Consequently, over the past twelve years, the SFO has taken legal action against cases involving fallacious and manipulative tendencies.[21] The powers of investigation of SFO under section 2 of the CJA 1987 are far-reaching, demonstrated on those possessed by the Department of Trade and

[17] Alexander (n15) 412.
[18] ibid; Wortherspoon (n12), 'Inside Dealing - The New Law: Pt V of The Criminal Justice Act.1993' (1994) 57 The Modern Law Review 333,421.
[19] Brenda Hannigan, *Insider Dealing* (Kluwer 1988) 117.
[20] Sarah Wilson, *The Origins of Modern Financial Crime in Britain* (Routedge 2014) 26–27; Rosalind Wright, 'Fraud After Roskill: A View From The Serious Fraud Office' (2004) 11 Journal of Financial Crime 1, 10.
[21] ibid.

Industry (DTI) by virtue of section 438 of the Companies Act 1985.[22] Nevertheless, after the decision of the European Court of Human Rights in *UK v Saunders*,[23] the authority to obtain self-incriminating evidence from individuals under investigation and at risk of conviction for contempt of court seems unlikely. In this case, the Court held that such a practice is against the European Convention on Human Rights (ECHR).[24] The SFO cannot impose sanctions, but as an investigating and prosecuting authority, it can gather proof of fraudulent activities and bring those responsible before the law.[25]

5.3.2 Fraud Act 2006

Under sections 1–4 of the Fraud Act 2006, individuals who dishonestly make false representations, dishonestly withhold information which they are under a legal duty to disclose, or dishonestly abuse positions of trust to make a gain for themselves or cause a loss to another, are guilty of the crime of fraud. Such individuals may be sentenced to a maximum of ten years' imprisonment upon indictment, as well as a fine.[26] While not all instances of market abuse would fall within the ambit of this Act, it may provide an avenue for the prosecution of the worst excesses.[27]

5.3.3 Financial Services Act 2012

Part 7 of the Financial Services Act 2012 sets out offences relating to financial services.[28] The first of these is contained in section 89 and concerns the making of misleading statements.[29] It applies where person makes statements knowing that they are false, as well as where he is reckless as to their veracity. Additionally it also

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[22] Petri Mäntysaari, *Comparative Corporate Governance* (Springer 2005) 165; PL Davies, LCB Gower and P. L Davies, Gower & Davies' *Principles Of Modern Company Law* (9th edn, Sweet and Maxwell 2012) 691–704.
[23] European Court of Human Rights in *Saunders v UK* (1997) 23 EHRR 313; [1998] 1 BCLC 362.
[24] ibid.
[25] Wright (n20) 1, 10.
[26] DC Ormerod and Karl Laird, *Smith and Hogan's Criminal Law* (Oxford University Press 2011) 823–25; Ian Dennis, 'Editorial – Fraud Act 2006' [2007] Criminal Law Review 1,1–2.
[27] See the full version of the Fraud Act 2006 at<http://www.legislation.gov.uk/ukpga/2006/35/contents> accessed 22 October 2015.
[28] Financial Services Act 2012: ch 21, Explanatory Notes 1,3; Andreas Kokkinis, 'The Financial Services Act 2012: The Recent Overhaul of The UK's Financial Regulatory Structure' (2013) 24 International company and commercial law review 325, 325-328.
[29] Financial Services Act 2012, s 89.

applies where person conceals material information.[30] In order for the offence to be completed, the accused must also be shown to have intended or been reckless to the fact that the person to whom the statements were made or from whom material information was concealed would resultantly enter into a relevant agreement, avoid entering into the agreement, exercise his rights under a relevant investment, or refrain from exercising such rights.[31] This offence was originally created by section 397 of the FSMA 2000.[32] An important point that has to be made with regard to this offence is the fact that the knowledge or recklessness of the defendant must be aimed at getting someone else to enter into a contract or to refrain from doing so, or to exercise their rights under an investment, or to refrain from doing so. The minimalist interpretation of this section would suggest therefore that where statements are made with an intention merely to effect changes in the market – for instance by causing the price of a stock to go up – there is no corresponding desire to influence any person to act in a particular way. In such an instance of market manipulation, the elements of this offence would not be made out. This, when compounded with the additional difficulty of proving the defendant's intentions, is responsible for the dearth of prosecutions under this section.[33]

Section 90 of the same Part creates another offence, namely that of creating a false or misleading impression in the market.[34] This, too, was originally created by the FSMA 2000 by virtue of section 397(3).[35] The offence comprises the following elements: the defendant must engage in a course of conduct that is intended to create an impression as to 'the market in, the price, or the value of any relevant investment',[36] and must either know or be reckless as to the fact that the impression that he is creating is false or misleading. The aim of the defendant in creating such an impression must be that of 'inducing another person to acquire, dispose of, subscribe for or underwrite those investments, or to refrain from doing so, or to exercise, or refrain from exercising, any rights conferred by those investments.'[37]

[30] Kokkinis (n28) 325–28.
[31] Noam Noked, 'Financial Services Act 2012: A New UK Financial Regulatory Framework' [2013] Harvard Law School Forum on Corporate Governance and Financial Regulation <http://corpgov.law.harvard.edu/tag/fsa/> accessed 22 October 2015.
[32] Financial Services Act 2012: ch 21, Explanatory Notes1,3.
[33] ibid; Noked (n31).
[34] FSMA 2000, s90.
[35] ibid s397 (3).
[36] ibid.
[37] ibid.

The point made with regard to section 89, namely that it is in practice extremely difficult to prosecute individuals for criminal activity, is worth repeating with regard to this offence as well. The difficulties in proving a defendant's state of mind to a court merely on the basis of his investments and/or actions with regard to the market present a formidable challenge.[38]

Section 91 of the FSA 2012 also defines a new offence.[39] This offence, which criminalizes the making or creation of false or misleading statements or impressions (respectively) with regard to certain set benchmarks, was created in the aftermath of the 2012 scandal whereby it was discovered that financial institutions had been illegally co-operating to fix the LIBOR exchange rate.[40] Currently, this is the only benchmark covered under this section. With regard to all three of the offences discussed above, it is pertinent to note that institutions too can be held guilty of their commission, which would appear to be a pragmatic approach given the fact that most high-value scandals have involved misconduct on the parts of whole organizations rather than a few bad individuals.[41] Even so, it is clear that if the criminal law is to fully satisfy its aim of penalizing such abusive practices, these sections need to be interpreted as liberally as possible. The increase in the use of technology has had a profound impact on the speed and complexity of ordinary investments, but it has also added difficulty to the task of policing the markets for unfair practices, as the examples of derivatives' contracts proved to the world in the last worldwide recession.[42] The difficulty of finding the requisite *mens rea* for these offences, bearing in mind the size of the markets and the complexity of modern stock trading, has also compounded this problem.[43]

[38] Karen Harrison and Nicholas Ryder, *The Law Relating To Financial Crime In The United Kingdom* (Ashgate 2013) 111; A Hudson, Law Of Financial Crime (University of London Press 2011) 18–19; Robert Falkner and Jon Gerty, 'Regulation Of Market Misconduct In The United Kingdom' (2005) 6 Journal of Investment Compliance 1, 49–51.
[39] Alan J Dignam and John P Lowry, *Company Law* (Oxford University Press 2014) 81.
[40] Louise Gullifer and Jennifer Payne, *Corporate Finance Law Principles and Policy* (Hart 2015) 599.
[41] ibid.
[42] Jonathan Fisher , Anita Clifforda, Freya Dinshawa and Nicholas 'Criminal forms of high frequency trading on the financial markets' (2015)9 Law and Financial Markets Review 1, 115–16; Government Office for Science, *The future of computer trading in financial markets: An international perspective* (London 2012) 43.
[43] Gullifer and Payne (n40) 600.

5.4 Civil Regulatory Provisions

As was noted above, market manipulation and insider trading have been prohibited in the UK from a long time. The first prominent statute directly regulating market manipulation and insider trading was the Financial Services Act 1986.

5.4.1 Financial Services Act 2012

Due to the rapidly evolving nature of the financial world, the law too needs to be constantly updated to keep pace. The Financial Services Act 1986 was followed and repealed by the Financial Services and Markets Act 2000, which in its amended form is the currently applicable law regulating Market Abuse (Market Manipulation and Insider Dealing) in the UK.[44] The FSMA 2000 is supplemented by the Code of Conduct created under section 119 by the FCA (formerly the FSA).[45] The Code of Conduct elaborates upon the FSMA 2000, giving useful guidelines such as the factors to be taken into account to reach certain determinations, and relevant examples. Section 118 of the FSMA 2000 forbids market abuse, listing seven behaviours that are considered to be abusive and fall under the scope of the FSMA 2000.[46] These seven abusive behaviours can be divided into two broader categories: the first three behaviours regarding offences relating to 'insider information' and the latter four constituting 'market manipulation'. These behaviours are explained in greater detail below:

1. Making, or attempting to make any investment or transaction in a qualifying investment on the basis of 'insider information' would constitute market abuse.[47] Insider information is defined primarily as information of a precise nature, which is not generally available, relates directly to the issuer of a qualifying investment or the said investment itself; and if made public would have a significant effect on the price of the qualified investment (this is a summary of insider information; article 118 C contains greater detail).[48] This section prohibits the generally known offence of 'insider dealing' as it

[44] Ormerod and Laird (n26) 823–25; Dennis (n26) 1,1-2.
[45] Cowan Ervine, *Core Statutes On Company Law* 2015-16 (Palgrave 2015) 235–36
[46] ibid 233–34.
[47] FSMA 2000, s 118(2).
[48] ibid s 118(c).

proscribes any individual from dealing in any securities, commodities, etc. to make a profit (or avoid a loss) on the basis of relevant secret/non-public information. An example would be a trader coming into possession of inside information about the imminent merger of a large company, or a telecommunications company, launching a new cell-phone which incorporates ground-breaking technology. Both are likely to drive the price of the respective companies' shares upwards. If the trader makes an investment or transaction on the basis of this information, he would have committed an offence under section 118(2) of the FSMA 2000.[49]

2. Disclosing of 'inside information' to a party other than in the proper course of employment or duties.[50] The first part prohibiting the disclosure of 'inside information' contains the prohibition whereas the second part 'otherwise than in the proper course of the exercise of his employment, profession or duties'[51] sets out the circumstances in which the first part would not incur a penalty or prohibition. The second part has been added with the understanding and acceptance that many individuals might be required to share and disclose inside information by virtue of their profession, duty etc. For example an employee in a firm might be under a duty to share information about an acquisition with a compliance officer, in which case he would not be in breach of section 118(3). While section 118(2) prohibits insider dealing in an effort to prohibit the spread of insider information, and hence the market abuse it may cause, section 118(3) prohibits any individual who comes into possession of such insider information from communicating it further.[52] In order to prove insider dealing under section 118(2) it would have to be shown that the passing of the inside information was part of some form of a 'deal' with an exchange of profit, gifts, etc. This would be harder to prove, as more evidence as to the entire 'deal' would have to be collected.[53] If the collection of all this evidence was not possible, as long as there was evidence that inside information was communicated the individual communicating the 'insider information' would be in violation of section

[49] In general see: Keith Wortherspoon, 'Inside Dealing - The New Law: Pt V of the Criminal Justice Act 1993' (1994) 57 The Modern Law Review 333, 419.
[50] FSMA 2000, s 118(3).
[51] ibid.
[52] FSMA 2000, s 118(3).
[53] ibid s 118(2).

118(3). In *Ian Hannam v The Financial Conduct Authority*,[54] two of the individuals involved (Julian Rifat and Paul Milson)[55] were traders who came into possession of inside information about certain companies in the course of their employment. They would disclose this inside information to another party who would use it to make transactions. The FCA held (and later the Upper Tribunal upheld) that the disclosure of 'inside information' by Julian Rifat and Paul Milson was in violation of section 118(3).[56]

3. Behaviour that is based on information not freely available to regular users of the market; information that if available to the regular user would be considered by him as relevant in making transactions/trades; and regarded by the regular user as a failure of the person exercising the behaviour to meet the standard of behaviour reasonably *expected*.[57] Section 118(4) prohibiting this behaviour of misuse of information only comes into operation when the abusive behaviour does not fall within sections 118(2) or 118(3) discussed above. As discussed, to prove the offence of insider dealing (section 118(2)) evidence as to the existence of a deal needs to be collected, and the disclosure of 'insider information' (section 118(3)) must be proven.[58] Successfully proving the offence does not require any evidence about how the offender came into possession of 'insider information', or how he disclosed it to another, only that he behaved on the basis of 'inside information'. For example, an offence would arise if the behaviour complained of is based on information which the law did not require to be disclosed (as a result of which it would not be 'inside information') at the moment the transactions were being made, yet the information was such that the regular user would feel it relevant, and would regard the behaviour as a failure of the person using the information to meet the standard of behaviour reasonably expected. In order to successfully prove a violation of section 118(4) FSMA 2000, the 'regular user' test it lays down must be satisfied.[59] It must be proven that the

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[54] *Ian Hannam v The Financial Conduct Authority* [2014] UKUT 233 (TCC), [2014] Lloyd's Rep FC 704.
[55] Martin Wheatley, 'The FCA Does Not Tolerate Conduct Which Imperils Market Integrity or The Wider UK Financial System' < http://www.lexology.com/library/detail.aspx?g=e3a8e24d-a84e-4007-81d6-869ede29b461> accessed 2 March 2015.
[56] ibid.
[57] FSMA 2000, s 118(4).
[58] ibid s 118(2), (3) and (4).
[59] ibid s 118(4).

information on which the behaviour is based would be considered by the regular user as relevant in making transactions in the qualifying investment, additionally that the regular user would regard the behaviour as a failure on part of the person concerned to meet the standard reasonably expected of a person in his position. The scope of section 118(4) went beyond that of the Market Abuse Directive (MAD); in amending the law to comply with the MAD the UK government retained section 118(4) for this reason.[60] It is pertinent to add that section 118(4) was subject to a 'sunset clause', under which it ceased to have effect on 31 December 2014.[61]

4. Behaviour involving the making of transactions or placing of orders, which creates or is likely to create either a misleading impression as to the price, supply or demand of a particular security; or sets the price of any such investment at an 'artificial level'.[62] Section 118(5) prohibits the creation of a false or misleading impression, and the setting of price at an artificial level, also known as 'price positioning'.[63] Examples of behaviour that creates a false or misleading impression include transactions that result in no change in ownership ('wash trades') or where an individual places multiple purchase orders in the last few minutes of the trading day, which would result in the closing price of the said securities increasing, which would in turn translate into a higher opening price the following day.[64] The price of the said securities is artificially inflated and not a true representation of natural market forces, as such the individuals who purchase the said securities during this artificial inflation period will be suffering a loss, as the price of the securities would have been artificially high. Once the momentum created by the manipulation settles the price would fall to its original/natural level, causing any recent purchasers loss.[65]

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[60] Slaughter and May, 'The EU/UK Market Abuse Regime-Overview' (2011) <https://www.slaughterandmay.com/media/39260/the-eu-uk-market-abuse-regime-overview.pdf> accessed 22 November 2015.

[61] FSMA 2000, s 118(9), as amended by the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2011 (SI 2011/2928), reg 2(2).

[62] An 'artificial level' is a level created not by natural market forces but induced by manipulative actions; FSMA 2000, s 118(5).

[63] Market Abuse Regulation (MAR) 1.6.4.

[64] MAR 1.6.2.

[65] ibid.

Behaviours that constitute the artificial setting of price include entering small subsequent orders consecutively at prices either higher or lower than the previous bid or offer, and entering corresponding purchase and sale orders to artificially create a price.[66] Section 118(5) accepts that the reasons behind certain transactions being made might be legitimate, and that such transactions may conform with accepted market practices, creating a safe harbour for such acts. Factors to be taken into account in deciding whether behaviour was legitimate include whether the transactions were a result of a prior legal or regulatory obligation owed to a third party; whether the transactions were effected in a manner taking into account the need for the market to function as a whole fairly and efficiently; and whether the transactions complied with the relevant rules as to the execution of transactions.[67]

5. Behaviour that includes employing fictitious devices or contrivances or any other form of deception when making trades or placing orders.[68] The FCA states that in deciding whether or not fictitious or deceptive devices or contrivances have been used, factors that must be taken into account include whether the making of the qualifying investments was accompanied by either false or misleading information or whether the person making the investment(s) had used erroneous research or a biased investment recommendation etc as the basis of their investment(s).[69] Two prominent examples of this behaviour are techniques known as ‘pump and dump’ and ‘trash and cash’.[70] Pump and dump is a strategy where a person creates a positive impression about securities he already owns, this positive impression causes an artificial price hike, at which point he sells his securities at the inflated rate.[71] In trash and cash, an individual creates a negative false impression of a particular security (he can do this by giving false information, rumours, statements, etc) which results in the price artificially falling, at which point the individual purchases the securities at the deflated

[66] MAR 1.6.4.
[67] ibid 1.6.6.
[68] FSMA 2000, s 118(6).
[69] MAR 1.7.3.
[70] MAR 1.7.2.
[71] ibid.

price.[72] This behaviour constitutes the useof any deceptive means, device, etc to manipulate the perceptions of people and then making transactions, etc to make a profit. The factors the FCA takes into account in deciding whether a breach of section 118(6) has occurred include whether the said transactions are accompanied by (either before or after) any false or misleading information by related persons; or if these persons produce or disseminate research or investment recommendations which are erroneous or biased or demonstrably influenced by material interest in the same timeframe as the transactions, etc.[73]

6. Behaviour that involves the dissemination of information by any method that either creates or is likely to create a false or misleading impression of a qualifying investment by an individual who knew or could reasonably have known that the impression was false or misleading.[74] In essence, this prohibits the creation of any false or misleading impression by any person acting knowingly. In theory, the prices of a particular security should represent the true value of that security (assets – minus liabilities of the company); however, in practice there exists an information gap. This is the gap between the knowledge of the investors and the actual state of the company (or the true value of the securities); this gap is filled by speculation. Any dissemination of information which investors believe likely to be true has an effect on the price. The prohibition on this behaviour concerns any attempt to manipulate supply, demand or price by false rumours. The term 'disseminating information by any method' is used, thus giving the provision a very wide scope, applying to all possible methods of dissemination (whether in person, on social media, print media or in any other manner). However, the provision also lays down the requirement that the person disseminating the information either knew or should reasonably have known

[72] MAR 1.7.2.
[73] MAR 1.7.3.
[74] FSMA 2000, s 118(7); Technical Committee of the International Organization of Securities Commission, Investigating and Prosecuting Market Manipulation 2000 <http://info.worldbank.org/etools/docs/library/156006/pillars/pdfs/bib/investigating.pdf> accessed 22 August 2015.

that their information was misleading or false.[75] As regards the factors to be taken into account in deciding when an act would be considered abusive under this head, the Code of Conduct states that where a 'normal and reasonable person' knew or ought to have known that the information was false or misleading, it can reasonably be assumed that the person disseminating the statement should have known as well.[76] Thus the Code of Conduct lays down an objective test to be used in determining whether section 118(7) has been violated.

7. Any behaviour which does not fall within the scope of behaviours 4 (section 118 (5) FSMA 2000), 5 (section 118(6) FSMA 2000) or 6 (section 118(7) FSMA 2000) above and is either likely to give a regular user of the market a false impression, or would be considered by the regular user as behaviour which is likely to distort the market for a qualifying investment falls under this category.[77] Section 118(8) FSMA 2000 is a catchall provision for market manipulation, drafted with the intention of encapsulating any behaviour that does not fall within the previous provisions. Section 118(8) consists of two parts, the first prohibiting the creation of a false or misleading impression and the second the commission of any behaviour which either distorts or is likely to distort the market in an investment. This provision, like section 118(4) above, uses the 'regular user' test, they both share this aspect, as both sections 118(4) and 118(8) are retained provisions from the original FSMA 2000 (before it was amended to comply with the MAD).[78] They were both retained as their ambit and scope were wider than the MAD regime, and legislators wanted to benefit from this.[79] The FCA gives two examples of behaviours that fall under section 118(8): (1) the behaviour of physical commodity stocks which might create a misleading impression about the price, supply, etc of a commodity or deliverable into a commodity futures contract; and (2) the movement of an empty cargo ship/vessel which might

[75] FSMA 2000, s 118(7).
[76] MAR 1.8.4.
[77] FSMA 2000, s 118(8).
[78] Mark Stamp and Daniel Simons, *Practical Company Law and Corporate Transactions* (Sweet & Maxwell 2011) 389; Slaughter and May (n60); Hogan Lovells,'Expiry date of "sunset provisions" in UK Market Abuse regime extended to 3 July 2016' <http://www.lexology.com/library/detail.aspx?g=4b244e77-0d48-4195-9720-db63c11b0e8b> accessed 10 October 2015.
[79] ibid.

create a false or misleading impression as to the demand, supply, price, or value of a commodity or deliverable in a commodity futures contract.[80] It is pertinent to add that section 118(8), like section 118(4), was subject to a 'sunset clause', under which it has ceased to operate on 31 December 2014.[81]

In order to provide greater clarity to section 118 FSMA 2000, the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005 and 2011 have added sections 118A, 118B and 118C to the FSMA 2000.[82] Section 118A is a jurisdiction clause, primarily explaining when section 118 would come into operation.[83] Section 118B defines an 'Insider' as being an individual in possession of 'insider information' either by virtue of a relationship (this can be in the course of his employment, as owner of share capital or by virtue of being part of a supervisory/government body) or by any other means (including through criminal activity).[84] Section 118C gives detailed criterion as to what constitutes 'insider information'.[85] The gist of this is that 'insider information' is information of a precise nature, related to a qualified investment, which is not freely available, and which if freely available would be likely to have a significant effect on the market price of the said security.[86]

As was seen above, in the UK dual civil and criminal regimes operate in an attempt to minimize abusive activity. Section 118 of the FSMA 2000 provides for the civil prohibition of market abuse (market manipulation and insider trading).[87] The criminal offence of market abuse is divided, primarily between sections 89, 90 and 91 of the Financial Services Act 2012 which contain the criminal offence of market manipulation and section 52 of the Criminal Justice Act 1993, which contains the criminal offence of insider dealing.[88] After the LIBOR scandal, several limitations in the existing criminal law on market manipulation (contained at the time in section 397 of the FSMA 2000) came to light.[89] As part of a reform package, sections 89, 90

[80] MAR 1.9.2.
[81] FSMA 2000, s 118(9), as amended by the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2011 (SI 2011/2928), reg 2(2).
[82] FSMA 2000, s 118 (A), (B) and(C).
[83] Ibid s 118 (A).
[84] ibid s 118 (B).
[85] ibid s 118 (C).
[86] ibid.
[87] ibid s 118.
[88] Harrison and Ryder (n38) 18-19; Falkner and Gerty (n38)1, 49-51.
[89] Financial Services Act 2012: ch 21, Explanatory Notes1,3.

and 91 of the Financial Services Act 2012 replaced the previous criminal law on market manipulation.[90] While sections 89 and 90 reflect the content of previous law, section 91 creates the new offence of benchmark manipulation, which was discussed in greater detail above.[91] It is arguable that criminal prosecutions and convictions act as a greater deterrent than civil suits; however, they are much harder to successfully prove as they place a higher burden of proof on the prosecution and a requirement of intent. In contrast, the civil regime under section 118 carries a lower burden of proof and no requirement to establish intent. In the civil regime when a claimant attempts to prove a violation of section 118 in practice he would have to meet the lesser evidential threshold of 'on the balance of probabilities', as opposed to the much higher burden of proving a case 'beyond reasonable doubt' for criminal prosecutions.[92] The civil proceedings under section 118 act as the primary regulatory tool on market abuse. It is used by the FCA to bring numerous proceedings and impose sanctions. An additional benefit of section 118 is that since it does not result in criminal convictions, most proceedings brought by the FCA result in settlements with the accused, resulting in a lesser burden on the courts and speedy results.[93]

'*Mens rea*' or 'intent' is the mental element behind the commission of a crime the mental resolution or the state of mind accompanying an act.[94] Where an offence has an 'intent' requirement, in order to prove that it has been breached, the claimant must show that the defendant had the requisite state of mind at the time. The Court of Appeal in *Winterflood Securities Ltd v Financial Services Authority*[95] held that for proving the offence under section 118 'the test is wholly objective; it does not require any particular state of mind on the part of the person whose behaviour is under consideration'. The absence of a requirement to prove 'intent' makes it easier to prove the civil claim under section 118 than it is to prove one under its criminal counterpart under sections 89, 90 and 91 of the FSA 2012 and section 52 of the Criminal Justice Act 1993.[96] However, while there is no requirement of intent, and the civil regime comes into effect by virtue of misconduct alone, the regulatory

[90] Dignam and Lowry (n39) 81.
[91] Harrison and Ryder (n38) 111; Hudson (n38) 18–19; Falkner and Gerty (n38) 6.
[92] FSMA 2000, s 118.
[93] Derek French, Stephen W Mayson and Christopher L Ryan, *Mayson, French and Ryan on Company Law* (Oxford University Press 2013) 345.
[94] *Black's Law Dictionary* (9th edn, West Group 2009) 881.
[95] *Winterflood Securities Ltd v Financial Services Authority* [2010] EWCA Civ 423.
[96] Joan Loughrey, *Corporate Lawyers and Corporate Governance* (Cambridge University Press 2011) 265.

authority has indicated that it will take into account whether or not the action of the accused was deliberate or not in deciding whether to bring a civil action.[97]

As was mentioned earlier, the task of monitoring market abuse was once with the Financial Services Authority, but has since been moved to the Financial Conduct Authority (FCA) as part of the significant overhaul to market and banking regulation in the UK following the most recent financial crisis.[98] It is interesting to note that, although relatively new, the FCA has been quick to combat market abuse since it was called into action with a number of high-value fines.[99] The fact that these fines have been advertised on its websites is a clear indication that the regulatory authority wishes to make use of publicity to deter other potential traders from engaging in such illegal activity. It is also interesting to note that that the compliance and control of market manipulation in the UK may be reaching new heights, with current considerations by the Serious Fraud Office regarding the use of spy agencies to uncover corporate wrongdoing.[100]

5.4.2 Companies Act 1985

There are two reasons for acute concern when the company provides financial aid to purchase its own shares. To begin with, it is probable that this is applied in a manner that affects either the company's interests or those of minority shareholders.[101] The second one is that the issuer may subsidize the prices of its own securities, which in turn could possibly and often has created misconceptions in the relevant securities as depicted in the *Guinness* case.[102]

However, when the company provides financial aid for buying of its own shares, this is not illegal practice *per se*. It is usually applied when the partners want to divide

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[97] R Wright, 'Market Abuse and Market Manipulation: The Criminal, Civil and Regulatory Interface' (2001) 3(1) Journal of International Financial Markets 19–25.

[98] Laura Cox and others, 'The United Kingdom Regulatory Reform: The Emergence of the Twin Peaks' [2012] COB 1.

[99] Financial Conduct Authority, 'FCA Fines US Based Oil Trader US $903K for Market Manipulation' (*FCA*, 22 July 2013) <http://www.fca.org.uk/news/fca-fines-us-based-oil-trader> accessed 5 October 2015.

[100] Carla Main, 'Weighing Chat-Room Ban, U.K. Fraud Spies: Compliance' (Bloomberg, 12 November 2013) < http://www.bloomberg.com/news/articles/2013-11-12/weighing-chat-room-ban-u-k-fraud-spies-compliance> accessed 12 November 2015.

[101] Alan J Dignam, S. H Goo and Andrew Hicks, *Hicks and Goo's Cases and Materials On Company Law* (Oxford University Press 2011) 54-55.

[102] D Donaldson and I Watt, *DTI Report, Guinness plc* (HMSO 1997).

their own company or assets.[103] It was illegal for a company to offer financial aid to a person in order to purchase their own shares or those of the parent company under section 54 of the Companies Act 1948. This Act was intended to protect company assets from abuse and to prevent the creation of fabricated markets.[104]

The 1948 Act was later substituted by sections 151–58 of the CA 1985.[105] The main aim of the prohibition did not change save that the requirement of equal treatment of shareholders was added.[106] To be more precise, section 151(1) CA 1985 prevents any company or any of its affiliates from providing financial aid to any individual who intends to purchase shares in that company.[107] Furthermore, section 151(2) prohibits a company from providing financial aid with the aim of reducing or eliminating the debt of a person who has purchased shares in the company.[108] The prohibition is pegged on the main reason why the financial aid was given.[109]

There is a broad definition of financial assistance provided for by section 152(1) of the Companies Act 1985; this includes aid given by a disclaimer or the settling of the debt. Despite the definition, the elements that make up financial assistance can be confusing. In this regard, the following test was based on the *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd.*[110]

> One must examine the commercial realities of the transaction and decide whether it can properly be described as the giving of financial assistance by the company, bearing in mind that the section is a penal one and should not be stretched to cover transactions which are not fairly within it ...[111]

Sections 153(1) and (2) modify the prohibition in section 151 to provide an exemption in the case where the company transacts for the purpose of addressing its own commercial interests and not as a way of offering financial assistance to a third

[103] David Milman, *Regulating Enterprise* (Hart 1999) 221.
[104] Ibid; Patrikios Pavlou and Associates LLC, Financial Assistance – still an issue? <http://www.legal500.com/c/cyprus/developments/3437.> accessed 23 November 2015.
[105] John Birds, *Annotated Companies Legislation* (Oxford University Press 2010) 800; B. G Pettet, *Company Law* (Longman 2001) 299–02.
[106] ibid.
[107] Companies Act 1985, s151 (1).
[108] ibid s151 (2).
[109] G Morse, *Charlesworth and Morse Company Law* (15th edn, Sweet and Maxwell 1995) 197.
[110] *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd* [1986] BCLC 1.
[111] ibid 10-11.

party in order to purchase its own shares.[112] The major obstacle created by these exemptions is that their interpretation can be extensive in terms of leveraged management buyout, which can in the end be financed by the company's funds.[113] In addition, section 153 (now section 678(2)) covers the concept of 'good faith' and the definition of different forms of behaviour or mental state that may fall under it, which makes it a crucial matter.[114] *Brady v Brady*[115] is the most illustrative and controversial case in that domain, whereby the court outlined what the terms 'purpose' and 'larger purpose' in section 153 implied.[116] In order to prevent outright dodging of section 151, the court assumed the restrictive view based on section 153. However, there has been serious criticism particularly with regard to *Brady's* unfavourable application to corporate restructuring.[117]

The injunction on giving financial aid is applicable even to affiliates who give financial aid for purchasing shares in the parent company. Justice Millett in *Arab Bank Plc v Mercantile Holdings Ltd* stated that financial aid provided by a subsidiary does not necessarily imply that it came from the parent company.[118]

However, he exempted cases that involve holding companies transferring assets to subsidiaries, which the subsidiaries use to facilitate acquisition of shares belonging to the holding company.[119] Section 151 does not apply to delivery of financial support by a foreign subsidiary of a UK holding company, due to conflicting laws and expansion of authority implications.[120] Although the principle of this decision is correct, and is based on particular facts, it is rather unhelpful in cases of share

[112] Companies Act 1985, s151 (1), (2) and (3).
[113] John Birds, *Annotated Companies Legislation* (Oxford University Press 2010) 800; Ben Pettet, *Company Law* (Longman 2001) 299–302.
[114] Janet Dine and Marios Koutsias, *Company Law* (Palgrave Macmillan 2007) 115; Anthony Arlidge and Jacques Parry, *Fraud* (Waterlow 1985) 161.
[115] *Brady v Brady* [1988] 2 All ER 617.
[116] ibid 633.
[117] B Pettet, 'Financial Assistance for the Acquisition of Shares: Further Developments' (1995) 9 JIBL 388, 390; Pierre-Hugues Verdier, 'Credit Derivatives and the Sovereign Debt Restructuring Process' (LLM paper, International Finance Seminar, Harvard Law School 2004) <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.198.2501&rep=rep1&type=pdf> accessed 23 November 2015.
[118] *Arab Bank plc v Mercantile Holdings Ltd* [1993] BCC 816.
[119] John Birds, *Annotated Companies Legislation* (Oxford University Press 2010) 800; Pettet (n117) 299-302.
[120] Companies Act 1985, s151.

support systems realized with funds of foreign combined subsidiaries, and it shows defective legislative drafting.[121]

Section 151 creates only a criminal offence just like its predecessor. However, the courts have decided that either party (*Brady v Brady*) can enforce an agreement to offer financial support.[122] In addition, *Selangor United Rubber Estates Ltd v Cradock (No 3)*[123] argues that any security or other types of financial arrangements such as mortgages, indemnity or guarantee specified to give financial support is invalid, and those parties that have rights to it cannot file lawsuits upon it.[124] Serious disapproval has recently been voiced concerning the application of section 151. This has primarily focused on the vagueness of its language.[125]

5.4.3 London Stock Exchange Rules

For monetary exchanges to be acknowledged as legal financial exchanges under the 1986 Act, they ought to adhere to several provisions, which safeguard the investors as well as the market's reputation.[126] The London Stock Exchange (LSE) has complied with the statutory provisions by issuing its own rules on trading, clearing and settlement, which every party associated with it must adhere to.[127] LSE members are prohibited by LSE rule [1400] from acting in a manner, which projects a deceptive impression on the demand or price of order book security.[128] The note also followed the proposal that a new rule be introduced to define forbidden behaviour as undertaking artificial trades, market manipulation and creating false prices.[129] In addition, the members of London Stock Exchange are required by LSE rule [1400, 1410] to rectify inaccurate statements if they happen to note the client has failed to adhere to the guidelines of releasing statement relayed through it or if they note that

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[121] Pettet (n 117) 302.
[122] *Brady v Brady* [1988] BCLC 579.
[123] *Selangor United Rubber Estates Ltd v Cradock* (*No 3*) [1968] 1 WLR 1555.
[124] *Heald v O'Connor* [1971] 1 WLR 497; Dignam, Goo and Hicks (n101) 304–305.
[125] Companies Act 1985, s151.
[126] Janette Rutterford and Marcus Davison, *An Introduction To Stock Exchange Investment* (Palgrave Macmillan 2007) 32.
[127] Donato Masciandaro, *Handbook of Central Banking and Financial Authorities in Europe* (Edward Elgar 2005) 356.
[128] 'Rules of The London Stock Exchange' Rule Book (The London Stock Exchange 2013) <http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/rules-lse.pdf> accessed 11 November 2015.
[129] London Stock Exchange Rule [1410].

the material released is misleading.[130] If a member fails to comply with the set guidelines, they may attract disciplinary actions, which may range from a fine or rebuke, to being banned from participating in that market. Nonetheless, investors who are not members of the LSE cannot claim compensation if there is a breach of the LSE's rules and, consequently, they suffer a loss.[131]

5.5 The Tribunal

Market abuse is not a new offence and has been known of for centuries, along with the realization of how it damages the free operation of the market.[132] It was combatted by, amongst other things, the creation of specialized forums and regulators. The formation of the Tribunal came much later; a number of different legal forums were adopted before this to adjudicate upon market abuse and its adjoining matters.[133]

5.5.1 History of the Tribunal and Other Specialized Courts

During the fourteenth century the main commercial towns in the UK were given the Court of Staples, where the merchants judged their own customs themselves – a form of *lex mercatoria,* one could argue.[134] The English courts of law and equity gradually expanded their jurisdiction, absorbing commercial law. In eighteenth century an attempt was made by Lord Mansfield to add a specialist element of corporate and mercantile expertise to the legal system, by adding specialist jurors from the City of London to deal with matters of fraud and commerce.[135]

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[130] London Stock Exchange Rule [1400 and 1410].

[131] ibid [1400].

[132] In General see: Edward J Swan and John Virgo, *Market Abuse Regulation* (Oxford University Press 2010).

[133] Stephen H Legomsky, *Specialized Justice: Courts, Administrative Tribunals, and a Cross-National Theory of Specialization* (Clarendon Press 1990); Peter Cane, *Administrative Tribunals and Adjudication* (Hart 2009) 125–27; Terence Ingman, *The English Legal Process* (Oxford University Press 2006) 115. Michael Lobban, 'Chantal Stebbings, Legal Foundations Of Tribunals In Nineteenth Century England' (Cambridge University Press 2007) 27 Law and History Review.

[134] Emily Kadens, 'The Medieval Law Merchant: The Tyranny Of A Construct' [2015] Journal of Legal Analysis, 3–5 <http://jla.oxfordjournals.org/content/early/2015/06/25/jla.lav004.full.pdf+html> accessed 2 July 2015.

[135] Leon E Trakman, *The Law Merchant : the evolution of commercial law* (Rothman 1983), 27–28; Emily Kadens, 'The Medieval Law Merchant: The Tyranny Of A Construct' [2015] Journal of Legal Analysis, 3–5 <http://jla.oxfordjournals.org/content/early/2015/06/25/jla.lav004.full.pdf+html> accessed 2 July 2015.

It is an established principle that no party should be condemned, hurt or penalized (with a sanction) without being given the opportunity of an appeal from the decision. As far back as the Prevention of Fraud (Investment) Act 1939, reference could be made to a 'Tribunal of Inquiry' where a party was aggrieved by the state's revocation of their licence.[136] This Tribunal of Inquiry was continued as before by the Prevention of Fraud (Investments) Act 1958.[137] The Financial Services Act 1986 (now repealed and replaced by the FSMA 2000) was the first to create a procedure whereby a reference to the regulator's decision could be made to an independent body.[138] The 'Financial Markets Tribunal' was established under section 96 of the FSA 1986.[139]

5.5.2 The Upper Tribunal (Tax and Chancery Chamber)

In April 2010 the Financial Services and Markets Tribunal was abolished and its functions were transferred to the Upper Tribunal established under the Tribunals, Courts and Enforcement Act 2007.[140] The Upper Tribunal was created as a means of consolidating tribunals in the UK, and has a number of divisions.[141] Appeals from decisions of the FCA (which in the past used to go to the Financial Services Market Tribunal), the Prudential Regulation Authority and from certain decisions of the Bank of England go to the Tax and Chancery Chamber of the Upper Tribunal.[142] The Upper Tribunal (Tax and Chancery Chamber) (referred to as the 'Tribunal') comprises of specialist judges appointed by the Lord Chancellor.[143] Any party aggrieved by a decision or determination (of the FCA, PRA or the Bank of England)

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136 Prevention of Fraud (Investments) Act 1958, ch 45; Jonathan Fisher and Jonathan Fisher, *The Law Of Investor Protection* (Sweet & Maxwell 2003) 13-14.
137 ibid.
138 Jonathan Fisher and Jonathan Fisher, *The Law Of Investor Protection* (Sweet & Maxwell 2003), 15-17.
139 Eilís Ferran and C. A. E Goodhart, *Regulating Financial Services And Markets In The Twenty First Century* (Hart Pub 2001) 11-12.
140 Terence Ingman, *The English Legal Process* (Oxford University Press 2006) 118.
141 ibid.
142 Carnwath, Tribunals and the Courts : the UK Model, (2011)24 Canadian Journal of Administrative Law and Practice, 1,5; Regulatory tribunals—overview <https://www.lexisnexis.com/uk/lexispsl/corporatecrime/document/391421/58K3-N0S1-F188-N0KD-00000-00/Regulatory+tribunals%E2%80%94overview> accessed 22 October 2015; Nigel Clayton, 'Failures In The Prudential Regulation Of Banks In The UK And US: Will The Lessons Be Learnt?' (2015) 9 Law and Financial Markets Review 1, 131-133.
143 ibid; Senior president of tribunals 2012–overview, Senior president of tribunals Annual Report, February 2012 <http://www.mentalhealthlaw.co.uk/media/SPT-annual-report-2012> accessed 23 October 2015.

seeking to make a reference can do so by filling a Reference Form (Form FTC3) and sending it to the Upper Tribunal (Tax and Chancery Chamber) within 28 days of notice of the disputed decision.[144] In the Reference notice the appellant must list the reasons or grounds on which he is referring the decision.[145]

Once the reference is accepted the tribunal office sends notifications to both the appellant and the respondent, giving the latter 28 days to respond via a statement of case (sent by him to the appellant and the tribunal).[146] The statement of case is meant to explain the reasons for the decision and to be supplemented by a list of the documents relied upon. On receipt of the statement of case the appellant has 28 days to reply via a rejoinder or reply to the statement of case (to both the Tribunal and the respondent), clearly stating all the things the appellant disagrees with in the statement of case, along with a list of all the documents relied on.[147] Once these motions are complete a judge in the Tribunal will decide whether a preliminary hearing is required or whether to proceed straight to the final hearing. The hearing will be preceded by a minimum of 14 days' notice (a shorter period only with mutual consent of the parties) after which an open public hearing will be held.[148] The panel hearing the reference usually comprises a judge and one or two non-legal members, but this is not a strict rule and in cases involving an extremely important point of law, up to three judges can sit together. The written decision of the Upper tribunal is sent to all parties later. Parties to a reference in the Upper Tribunal have the right to appoint representatives and in limited circumstances it is also possible that legal aid might be available. Although the Tribunal has no fee for bringing a reference in circumstances where it feels that one party was acting unreasonably, it can order it to bear the other party's costs.[149] In reality, the author considers this stance to be the best way of ensuring an appropriate balance between providing access to justice and having an eye on the overriding objective under the Civil Procedure Rules.

The procedure to be adopted and rules to be followed by the Tribunal are given by the Tribunal Procedure (Upper Tribunal) Rules 2008, which came into force on 1

[144] The Tribunal Procedure (Upper Tribunal) Rules 2008 (SI 2008 No 2698 (L 15)), point 2, sch 3
[145] ibid; 'The Prudential Regulation Authority approach to banking supervision' (April 2013) <http://www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1304.pdf> accessed 10 October 2015.
[146] The Tribunal Procedure (Upper Tribunal) Rules 2008 (SI 2008 No 2698 (L 15)), point 4, sch 3
[147] ibid point 5 sch 3.
[148] ibid point 4 sch 3.
[149] ibid point 10 sch 3.

November 2013. Under rule 26-B of the Rules the provisions governing financial services cases are contained in Schedule 3.[150]

5.5.3 Appeals

Any of the parties to the reference that is aggrieved by the decision of the Upper Tribunal can with permission (either from the Tribunal itself, or on its refusal from the Court itself) appeal the Tribunal's decision to the Court of Appeal (to the Court of Sessions, in Scotland).[151] This right of appeal exists only in relation to a point of law and the Tribunal's determination as a fact-finder is considered final. Usually the appeal must be made within one month.[152]

5.6 European Union Law

The above discourse clearly demonstrates that the UK is keen to impose both deterrent and penal measures in relation to market manipulation. Part of this drive may be further advanced by the proposals on the European sphere which seek to increase the criminal sanctions and create greater harmonization on a wider scale;[153] the next subsection of this paper consider the current European influence and also consider how the new proposals could change the manner in which market manipulation is regulated.[154]

The English law on market abuse has developed greatly from basic case law at one time, to section 118 of the FSMA 2000 now, and is still developing.[155] These changes however have not always been caused by internal reasons. In the aftermath of the chaos and destruction of the Second World War, in an attempt to avoid any such future catastrophe, measures were taken for greater European integration. These

[150] The Tribunal Procedure (Amendment No-4) Rules 2013 <http://lawvolumes.dwp.gov.uk/docs/a1-7485.pdf> accessed 23 October 2015.
[151] Tribunals, Courts and Enforcement Act 2007: ch 15, explanatory notes, 18–19.
[152] Frederic P. Miller, Agnes F. Vandome and John McBrewster, Upper Tribunal (VDM Publishing, 2010); Gambling Act 2005: ch 19, Explanatory Notes, 65.
[153] Rüdiger Veiland, *European Capital Markets Law* (Hart 2013).
[154] Gabriël Moens and John Trone, *Commercial Law of The European Union* (Springer 2010) 144; Jerry W Markham, *Law Enforcement and The History of Financial Market Manipulation* (Routledge 2014) 451.
[155] Nicholas Ryder, *Financial Crime in The 21St Century* (Edward Elgar 2011) 166–68.

measures cumulated in the formation of the European Union of today.[156] One of the key aims of the EU is economic progress and the strengthening of the European Markets.[157] Having understood the toll abusive market practices take on the economy the EU took measures to end market abuse. With the UK becoming a member of the EU it was under a duty to transpose or implement these measures in the form of EU law in its markets.[158]

5.6.1 Insider Dealing Directive

The first of these measures came in the form of Council Directive (89/592/EEC) of 13 November 1989, the Insider Dealing Directive.[159] At the time of its inception most member states did not have laws prohibiting insider dealing, which was considered a routine part of market operation.[160] This is aptly demonstrated in *Rothschild v Brookman*,[161] a case where the accused advised the claimant to buy a particular bond, selling to him those he already owned, without informing him that the bonds he was being advised to purchase belonged to the advisor himself. Lord Wynford opined:

> But I do not mean to say that Mr. Rothschild gave him that advice with any dishonest view whatever; I have no doubt he acted fairly and properly: but the ground on which I am disposed to move your lordships to affirm this judgment goes wide of that. I am firmly persuaded that many bankers and many stockbrokers in London have acted precisely in the same manner as Mr. Rothschild acted on this occasion. God forbid that I should say that these gentlemen, or any of them, have taken advantage of the confidence that was reposed in them; and, under colour of proceedings such as have taken place here, that they have injured the parties who so trusted to them.

The Insider Dealing Directive, article 2 imposes a duty upon member states to prohibit insider dealing. It is pertinent to note that while the Directive attempted to proscribe insider dealing (in a limited manner, based on the definition of the time) it

[156] ibid.
[157] Niamh Moloney, *EC Securities Regulation* (Oxford University Press 2014) 27.
[158] Swan and Virgo (n132).
[159] Raffaello Fornasier, 'The Directive On Insider Dealing' (1989) 13 Fordham International Law Journal 111, 178.
[160] ibid.
[161] Rothschild v Brookman (1831) II Dow and Clark 188, 6 ER 699..

was silent as to and completely neglected the abusive practice of market manipulation.[162]

5.6.2 Market Abuse Directive

The Market Abuse Directive (MAD)[163] introduced in 2003, replaced the Insider Dealing Directive.[164] The MAD introduced the category of 'market abuse', which is a broad category encompassing both market manipulation and insider dealing. This Directive was the first major step aimed at standardizing regulation of market abuse across Europe. It was also the first Directive introduced on the basis of the Lamfalussy process, which created four levels of legislation to introduce certain European regulatory acts towards the national legislative systems of member states.[165] The First Level consists of basic framework principles in the form of EU legislation; the Second Level comprises of greater detail on the provisions introduced in the First Level; the Third Level comprises of tools aimed at the strengthening of communication and cooperation between regulators to achieve greater regulatory consonance and implementation; and the Fourth Level is the member states ensuring that the European laws are thoroughly implemented nationally.[166] As such the MAD was the First Level instrument providing the basic framework and goals to be achieved in the elimination of market abuse.[167]

The MAD begins in article 1 by defining a number of terms it later uses, including 'insider information', 'insider' and 'market manipulation'.[168] Articles 2 and 3 forbid insider dealing; additionally they also prohibit any individual who is in possession of 'insider information' from disclosing such information to any person who may act on it.[169] Article 5 proscribes the practice of market manipulation.[170] The MAD also

[162] Insider Dealing Directive, art 2; Iwona Seredyńska, Insider Dealing And Criminal Law (Springer 2012) 22; Raffaello Fornasier, 'The Directive On Insider Dealing' (1989) 13 Fordham International Law Journal 111, 163.
[163] Directive 2003/6/EC [2003] of the European Parliament of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse).
[164] Moloney (n159) 699; J. Lau Hansen and D. Moalem, 'The MAD Disclosure Regime And The Twofold Notion Of Inside Information: The Available Solution' (2009) 4 Capital Markets Law Journal 276, 323; Guido A. Ferrarini, 'The European Market Abuse Directive' (2004) 41 Common Market Law Review 631, 711–12.
[165] I Seredyńska, *Insider Dealing and Criminal Law Dangerous Liaisons* (Springer 2012) 6.
[166] ibid 7.
[167] Alastair Hudson, Securities Law (Sweet and Maxwell 2008) 97.
[168] Market Abuse Directive 2003, art 1.
[169] ibid arts 2 and 3.

stipulates that adequate investigative and supervisory powers be made available to the 'competent body' so as to enable it to fulfil its mandate.[171] Under article 15 the MAD imposes a responsibility on member states to provide an appeal to the party affected by the decision of the competent authority.[172] Furthermore, in an attempt to reduce cross-border abusive practices and strengthen European regulation, article 15 instructs the 'competent authorities' of member states to work together and assist each other.[173]

Different forms of EU legislation (regulations, directives, etc) take effect in different manners/modes.[174] When a directive is passed it acts as an instruction to the member states conveying the goal or aim to be accomplished. While the directive gives the member state the end or goal to be achieved, the manner in which this is to be achieved is left to member states.[175] As such, while the MAD categorizes the acts to be prohibited, member states' have discretion as to how to implement it. Since EU law makes it mandatory for member states to implement Directives the UK government had to decide how to give effect to it within its national legal system.[176]

The advantage of such a measure is that it gives the member state the opportunity to implement measures without restriction and to do so in a manner that best suits their characteristics. The disadvantage then is that there is a lack of uniformity. This is indeed an argument that can be argued from both sides of the fence on the same point.[177]

The Financial Services and Markets Act 2000 ('FSMA') broadly complied with some of the aims of the directive; however, there existed significant differences, which required that further steps be taken. The UK government could either implement the MAD, retaining some of the provisions of the existing law which had wider application, or axe the existing law and introduce the MAD provisions in their

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[170] ibid art5.
[171] ibid art12.
[172] It is likely that the necessity of providing this concept arises out of '*audi alteram partem*', meaning no one should be condemned unheard. It is considered a fundamental right that wherever a party is affected by a decision, it be given the right of appeal in front of an independent appeal forum. In the UK this was satisfied by the creation of the Financial Services and Markets Tribunal created under the FSMA 2000.
[173] Market Abuse Directive 2003, art15.
[174] Hudson (n167) 26.
[175] ibid.
[176] John Wheeler, *The English Legal System* (Longman 2002) 108.
[177] Iris H. Y Chiu, *Regulatory Convergence In EU Securities Regulation* (Wolters Kluwer 2008) 70–71.

entirety anew.[178] Some of the prominent differences between the FSMA 2000 (as first enacted) and the MAD were: (1) that the former applied more to UK markets, whereas the latter covered every investment traded in every EU market if the abusive behaviour had occurred in the UK; (2) the MAD applies to 'transactions' only, whereas the FSMA 2000 has wider ambit, applying to underlying derivatives; and (3) it is also believed that the definition of 'inside information' is narrower in the MAD as it requires it to be 'precise', which may not include all abusive behaviour.[179] In light of all these factors the UK government decided to retain part of the old law, amalgamating it with provisions of the MAD to retain the wider provisions while giving effect to the directive.

The result of broad compliance as to total compliance is reflective of the difficulties in creating legislation through the use of a directive; the game of Chinese Whispers comes to mind, and the result being the establishment of diverse laws on the same subject across the continent.

The FSMA 2000 already contained many of the provisions and achieved many of the target controls aimed for by the MAD.[180] However, the provisions of the MAD that the FSMA 2000 did not already give effect to have been given effect in the UK by the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005, the Investment Recommendation (Media) Regulations 2005, Financial Services Authority 2005/15 – Market Abuse Directive Instrument 2005 and Financial Services Authority 2005/16 – Market Abuse Directive (Disclosure Rules) Instrument 2005 which transpose the remaining Directive into domestic law.[181]

5.6.3 The Market Abuse Regulation

The Market Abuse Regulation 2014 (MAR) followed the MAD, entering into force on 2 July 2014.[182] The Regulation states that the Market Abuse Directive completed

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[178] Slaughter and May (n60).
[179] ibid.
[180] Guido A. Ferrarini, 'The European Market Abuse Directive' (2004) 41 Common Market Law Review 631, 711–12.
[181] ibid; Official website of the European Union <http://ec.europa.eu/internal_market/finances/docs/actionplan/transposition/uk/d13.1-ct-uk.pdf> accessed 5 November 2015.
[182] Niamh Moloney, *EU Securities and Financial Markets Regulation* (3edn, Oxford European Union Law Library 2014), 699-700; Christian Kersting, 'Insider Dealing And Ad Hoc Disclosure

and updated the European Union's legal framework to protect 'market integrity' from market abuse. The Regulation further states that in the past decade since the coming of the directive, 'considerable changes' have occurred in the financial landscape. One of the substantial changes brought about by the MAR is that, unlike its predecessor, it takes a very wide approach to the markets and circumstances it applies to. Unlike its predecessor the MAR applies to any financial instrument that is traded on a 'multilateral trading facility'[183] or on an 'organized trading facility'.[184]

Insider dealing is prohibited by article 8 of the MAR, as it was under article 2 of the MAD before it.[185] In regard to insider dealing the MAR is linguistically and structurally constructed very similar to the MAD.[186] The MAR does however extend the definition of insider dealing in two ways: first, where an individual places an order before coming into possession of insider information, but after receipt of which he cancels or alters it, he would be liable for insider dealing. Secondly, article 14 of the MAR introduces the inchoate offence of attempting to commit insider dealing.[187] Under the article 14 offence an individual would be in violation even if his behaviour in attempt of insider dealing was unsuccessful.[188]

Article 12 of the Regulation prohibits 'market manipulation'.[189] But while the application of article 2 of the MAD was limited to 'financial instruments',[190] article 12 additionally applies to 'related spot commodity contracts' and 'auctioned products'.[191] The sale and purchase of spot commodity contracts and auctioned products are interconnected with the markets, thus by adding them into the scope of

Requirements In The New EU Market Abuse Regulation' (2014) 33 Banking and Financial Services Policy Report 15.

[183] Investopedia explains MTFs as: 'Multilateral trading facilities offer retail investors and investment firms an alternative venue to trading on formal exchanges. Additionally, MTFs have less restrictions surrounding the admittance of financial instruments for trading, allowing participants to exchange more exotic assets.': 'Multilateral Trading Facility – MTF' (*Investopedia*) <http://www.investopedia.com/terms/m/multilateral_trading_facility.asp> accessed 28 November 2015.

[184] Art 4(1) point 23 of the Markets in Financial Instruments Directive (MiFID defines an OTC as: 'a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with Title II of this Directive'.

[185] MAR 2014, art 8 & MAD 2003, art 2.

[186] Niamh Moloney (n182) 700–01

[187] MAR 2014, art 14.

[188] Ibid; Martin Sandler and others, Market Abuse 'Compliance Officer Bulletin' 2014.

[189] MAR 2014, art 12.

[190] MAD 2003, art 2.

[191] MAR 2014, art 12.

market manipulation the MAR is filling the void left by the previous laws.[192] This is criticized on the basis that (1) it creates difficulty for competent/regulatory authorities in member states in regulating behaviour in a market for which the MAR is not responsible, and (2) it creates uncertainty for commodity traders in not knowing whether their commodities fall within the scope of the MAR or not.[193] Article 15 makes it an offence to 'attempt' to commit market manipulation.[194] By the creation of this inchoate offence, even those individuals who attempted to manipulate the market, albeit unsuccessfully, would now be caught by the provisions of the law.

It is also pertinent to note that MAR is a Regulation (unlike the Insider Dealing Directive and MAD discussed above), and under EU law, Regulations come into direct effect as well as being directly enforceable in member states, without the need for member states to pass transposing legislation. On application, the MAR will bring major changes in the securities and financial market regulation in the member states of the EU. Most of the provisions of the MAR (including the main market manipulation and insider dealing clauses) will take effect in 2016.[195]

5.7 Notable Incidents of Market Abuse

The past few years have seen a remarkable number of market abuse cases in the UK, from the LIBOR scandal to Operation Tabernula. The FCA (previously the FSA) has used the tools at its disposal going after individuals and legal persons alike. Some of the most prominent of these cases are detailed below.

[192] M Sandler and others, 'Market Abuse' (August 2014) 118 Compliance Officer Bulletin, COB 1-37, 12.
[193] ibid.
[194] MAR 2014, art15.
[195] Stuart Willey and Carmen Reynolds, 'The New European Market Abuse Rules - Looking Towards 2016: Pt 1' [2015] White and Cases LLP; Charlotte Hill, The market abuse regulation: are we nearly there yet? (Financier Worldwide Magazine 2015) <http://www.financierworldwide.com/the-market-abuse-regulation-are-we-nearly-there-yet/#.Vj93FP5F1aQ> accessed 23 October 2015.

5.7.1 Ian Hannam

Ian Hannam was the chairman of Capital Markets at JPMorgan and the global co-head of Capital Markets at JP Morgan Cazenove.[196] One of JP Morgan's clients was 'Heritage', an oil and gas company.[197] Hannam sent two emails dated 9 September 2008 (referred to as the 'first email') and 8 October 2008 (referred to as the 'second email') containing 'market sensitive' information.[198] Both of the emails were sent to Dr Ashti Hawrami, the Kurdish Natural Resource Minister, and the second one was blind copied to Mr David Ishag, an advisor to a potential investor in companies in Kurdistan.[199] The subject of the first email was that Heritage was at the receiving end of a takeover bid, and that of the second email that Heritage had found oil. The regulator at the time, the FSA, held that Hannam had been guilty of two instances of market abuse by disclosing inside information otherwise than in the proper course of employment, in violation of section 118(3) of the FSMA 2000, and fined him £450,000. As discussed above, section 118(3) prohibits the disclosing of any 'inside information' other than in the proper course of employment, profession or duties.[200]

Aggrieved by the FSA's decision, Ian Hannam appealed it to the Upper Tribunal (Tax and Chancery Chamber) on the grounds that the information disclosed in the emails did not amount to 'insider information'. The Tribunal in *Ian Hannam v The Financial Conduct Authority*[201] considered a number of important matters before giving its ruling. The second email read, 'PS – Tony [Buckingham] has just found oil and it is looking good.'[202] Hannam had argued at the hearing that Heritage had never found oil as that would have been understood by the concerned parties as 'black oil'. This factum was accepted by both sides with Heritage only finding liquid hydrocarbons in the course of their drilling. While Hannam argued that the information was not accurate, the FCA on the other hand argued that the statement in

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[196]Michael Green, 'Acceptable delay in disclosure of inside information' (2014)29 Journal of International Banking and Financial Law 563, 567.
[197] ibid.
[198] Slaughter and May, 'Upper Tribunal finds against Ian Hannam' (June 2014). <http://www.slaughterandmay.com/media/2166752/upper-tribunal-finds-against-ian-hannam.pdf> accessed 24 October 2015.
[199] ibid.
[200] Michael Green, 'Acceptable delay in disclosure of inside information' (2014)29 Journal of International Banking and Financial Law 563, 567; Slaughter and May (n198).
[201] *Ian Hannam v The Financial Conduct Authority* [2014] UKUT 233 (TCC), [2014] Lloyd's Rep FC 704.
[202] Slaughter and May Upper (n198).

its ‘entirety amounted to insider information’. The FCA argued that information did not have to be entirely accurate in order to give a party a comparative market advantage; ‘insider information’ cannot thus be required to be completely true. The Tribunal, after a lengthy discussion, decided that even inaccurate information can have the same abusive effect on the market as true information. The Tribunal opined:

> This will be a heavily fact dependent exercise. To put this another way, there are degrees of inaccuracy and each case must be judged against the facts. If the inaccuracies do not detract in any significant way from the genuine facts then the information must be inside information. If the correct facts are still recognisable despite the inaccuracies, then in our view, the information would still be inside information.[203]

The Tribunal decided that Hannam’s first email passed the highest test, that the information contained therein would significantly affect the price of the shares of Heritage.[204]

5.7.2 LIBOR Scandal

LIBOR (London Interbank Offered Rate) is the rate of interest which a number of the world’s most prominent banks charge each other interest for short-term borrowing of funds.[205] LIBOR is used as a reference rate for multiple financial instruments and derivatives which use it as a standard. It is described by the FSA as ‘benchmark reference [rate] fundamental to the operation of both UK and international financial markets, including markets in interest rate derivatives contracts’.[206] LIBOR is also used in derivative markets in the US.[207] It is used as a reference rate in financial derivatives, financial products and student loans (amongst other things), thus manipulation of the LIBOR in effect results in manipulation of the derivatives market. LIBOR also acts as an indicator or measure of the total health of the system: if LIBOR is low, it shows that the banks are in good condition with the

[203] *Ian Hannam v The Financial Conduct Authority* [2014] UKUT 233 (TCC), [2014] Lloyd’s Rep FC 704, para 72.
[204] ibid; William Savitt, The Securities Litigation Review (Gideon Roberton 2015) 77-78; Slaughter and May (n198).
[205] David Hou and David Skeie, ‘Origins, Economics, Crisis, Scandal and Reform’ (Federal Reserve Bank of New York Staff Reports, no- 667. March 2014). <http://www.newyorkfed.org/research/staff_reports/sr667.pdf> accessed 24 October 2015.
[206] N Ryder, ‘The Good, the Bad and the Ugly’ (2014) 221 Criminal Lawyer 5–6.
[207] Edward V. Murphy, Libor: Frequently Asked Questions (Congressional Research Service, July 16, 2012) <https://www.fas.org/sgp/crs/misc/R42608.pdf> accessed 24 October 2015.

banking industry being in good health; on the other hand, a high LIBOR means the exact opposite, portraying poor health in the banking industry. LIBOR manipulation was first brought to prominent attention in 2005 when it was alleged that Barclays Bank attempted to manipulate the LIBOR (and the EURIBOR). There were additional attempts to do so by Barclays in 2006 and 2007.[208] Before long, the low LIBOR rate began to be questioned on multiple forums. The New York Federal Reserve stated that it had received communications by multiple banks that LIBOR was 'being set unrealistically low', and in 2008 the *Wall Street Journal* questioned the reliability of LIBOR, stating that 'some banks do not want to report the high rates they are paying for short-term loans because they do not want to tip off the market that they are desperate for cash. The LIBOR system depends on banks to tell the truth about their borrowing rates'.[209]

In 2009, various regulators, including the FCA, the Serious Fraud Office (SFO) and the Securities and Exchange Commission (of the USA) started investigating instances of manipulation of LIBOR (all of which collectively are referred to as the 'LIBOR scandal'). During the investigation, on 27 June 2012, Barclays admitted its involvement and was fined £59.5 million[210] by the FSA individually (many believe that this was done to set an example, as it was the largest fine issued by the FSA at the time), and a total fine of £290 million.[211] A number of other banks involved in the LIBOR scandal were also heavily fined: UBS (£940 million), RBS (£390 million) and Rabobank (£662 million).[212] In addition to financial penalties being imposed on panel banks that were actually responsible for manipulating LIBOR, two interdealer brokers, ICAP (£55 million) and RP Martin brokers (£1.3 million), were also fined.[213] They were fined on the grounds that they were important intermediaries between investment banks, and were implicated, having attempted to influence intermediaries. Imposition of the extremely high fines and the widening of the scope to include even those parties who were not panel banks directly

[208] Ryder (n206).
[209] ibid.
[210] ibid.
[211] T Dane, 'LIBOR Scandal: Two Years On' (*Nabarro*, 4 June 2014) <http://www.nabarro.com/insight/briefings/2014/june/libor-scandal-two-years-on/> accessed 22 October 2014.
[212] ibid.
[213] Robert Patton, Trends in Regulatory Enforcement in UK Financial Markets 2014/15 Mid-Year Report 20 October 2014.
<http://www.nera.com/content/dam/nera/publications/2014/PUB_FCA_Trends_A4_1014_final.pdf> accessed 22 October 2015.

responsible for the LIBOR manipulation showed how seriously LIBOR manipulation was viewed.[214]

After witnessing the grave and ubiquitous LIBOR scandal, the UK government held the Wheatley Review, with the purpose of calculating and regulating LIBOR.[215] On 28 September 2012, the review reached the conclusion that despite its failings, LIBOR needed to be reformed, not abandoned. Some of the salient points of the Wheatley Review were that the regulation of LIBOR should be transferred from the British Bankers Association to a new administrator;[216] a new statutory regulation of administration and submission should be set up;[217] and the creation of new criminal offences for the manipulation of LIBOR.[218] As a result of the LIBOR scandal and incorporating the suggestions of the Wheatley Review, the FSA 2012 was passed. The FSA 2012 reformed the existing FSA into the FCA, giving it responsibility to ensure that the new rules were complied with. The FSA 2012 also repealed the existing section 397 of the FSMA 2000 containing the criminal offence of market manipulation;[219] and added sections 89, 90 and 91. While sections 89 and 90 primarily replicated the provisions of the repealed section 397, section 91 created a new offence, prohibiting the making of a false or misleading statement or doing of any act or engaging in any conduct which creates a misleading impression etc in relation to a benchmark. The addition of the offence under section 91 is a direct result of the LIBOR scandal, where the absence of a provision outlawing the said behaviour was vary apparent. At the time, the FSA did not have adequate options to bring criminal prosecutions, as the criminal justice system was not equipped to deal with the offences of benchmark manipulation. Later the Wheatley Review suggested that such an amendment be made.[220]

The LIBOR scandal and the regulatory/reformatory measures that followed led to many changes. First, the reformative structure was changed by the creation of the

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[214] ibid.
[215] Kristen Dooley, 'The Libor Scandal,Review of banking and financial law' (2012)32 Boston University School of Law 1, 3.
[216] The Wheatley Review of LIBOR: Final Report (September 2012) 8<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_finalreport_280912.pdf> accessed 22 October 2015.
[217] ibid 11.
[218] ibid 18–19.
[219] Financial Services Act 2012, s 95.
[220] V Callaghan and Z Ullah, 'Legisl tive Comment: The LIBOR Scandal – The UK's Legislative Response' (2013) 28(4) Journal of International Banking Law and Regulation, 1, 160–165.

Prudential Regulatory Authority and the transformation of the FSA into the FCA.[221] Secondly there was also legal reform, with section 91 creating a new criminal offence adding to the criminal powers of the FCA and demonstrating that the government planned to not tolerate any such abusive behaviour in the future.[222]

5.7.3 Gold Price Fixing (Barclays and Plunkett)

Daniel James Plunkett was a director at the precious metals desk at Barclays, which was responsible for the pricing of products linked to precious metals. Plunkett's job was to manage Barclay's risk on a digital exotic options contract that referenced the price of gold at 3 pm on 28 June 2012. The price contained a barrier: if the price were to bet fixed above the barrier, Barclays would be required to pay its customer; however, if the price were to be set below the barrier, Barclays would not have been required to pay its customer. Taking advantage of the weak internal controls set by Barclays, Plunkett placed multiple orders, aiming to influence the price being set below the barrier. Plunkett succeeded in this task: not only did Barclays not have to pay a customer $3.9 million, Plunkett's book profited by $1.75 million as a result of the manipulation. The customer solicited an explanation as to why the price had been set just below the barrier. Plunkett gave a fabricated account of events, completely failing to disclose that he had placed orders during the gold price fixing.[223]

On investigating, the FCA found Barclays to be in breach of Principles 3 (Management and Control) and 8 (Conflict of Interest) of its Principles of Business.[224] The FCA concluded that there was a failure to implement adequate policies to manage; to create systems that allowed for adequate monitoring of traders activity; and to provide special training to the relevant metals desk staff in regard to gold fixing.[225] Barclays participation in gold fixing while contributing to the price fixed, as well as selling to customers options dependent upon the gold price fixed,

[221] Dooley (n215) 1, 7–9.
[222] V Callaghan and Z Ullah, 'Legislative Comment: The LIBOR Scandal – The UK's Legislative Response' (2013) 28(4) Journal of International Banking Law and Regulation 1, 160–165.
[223] Jane Tuckley and Stephen Paget-Brown, 'FCA enforcement action: themes and trends' (2015) 125(Apr) Compliance Officer Bulletin.
[224] ibid.
[225] FCA, 'Barclays Fined £26m for Failings surrounding the London Gold Fixing and former Barclays Trader Banned and Fined for Inappropriate Conduct' (FCA, 23 May 2014) <http://www.fca.org.uk/news/barclays-fined-26m-for-failings-surrounding-the-london-gold-fixing> accessed 25 October 2015.

was a conflict of interest under Principle 8 of the Principles of Business.[226] Conflict of interest has been penalized as far back as 1831 in *Rothschild v Brookman*.[227]

Mr Rothschild had advised one of his clients to sell French government bonds and buy Prussian government bonds instead. The client was given the impression that the trades would be conducted with third parties, whereas unbeknown to the client both his sale and purchase transactions were with Mr Rothschild himself. Later the price of the French bonds rose and the Prussian bonds fell, resulting in a loss to the client. When the case was appealed to the House of Lords, Lord Wynford opined:[228]

> the law your Lordships are called on to administer is a law of jealousy, and it will not allow any man to be trusted with power to take advantage of the weakness or ignorance of others. In every one of these transactions the Appellant has had the opportunity to do this, and though I believe he is not capable of doing it, we must deal with him as we should do with others, and say that he shall not put himself in a situation where he could be able to exercise such a power.

Thus even when the practice was not expressly outlawed, their Lordships understood and penalized a trader being in a position where his tasks, by virtue of his position created a conflict of interest. This principle was so important for smooth and honest market dealings that it is now codified as Principle 8 of the Principles of Business.

Barclays was fined £37,190,800 and Plunkett £136,600 by the FCA, which they both settled without appealing.[229] This also demonstrated how seriously the FCA views a trader prioritizing his personal interest over that of his client. Additionally it also demonstrates how far the FCA holds responsible larger financial institutions for not adequately adhering to their rules and guidelines.[230]

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[226] Principles for Businesses – Financial Conduct Authority. <http://www.fca.org.uk/static/documents/handbook-releases/high-level-standards136.pdf> accessed 25 October 2015.
[227] Rothschild v Brookman (1831) II Dow and Clark 188, 6 ER 699.
[228] ibid.
[229] Tuckley and Paget-Brown (n223) 25–30.
[230] ibid.

5.7.4 Operation Tabernula

‘Operation Tabernula’ was a long-running joint investigation between the outgoing FSA and the Serious Organised Crime Agency, and latterly the FCA.[231] It was a continuing investigation into a number of insider dealing cases, and in 2010 was the FCAs largest and most high-profile case (in actuality it was a collection of cases).[232] One of the key subjects of the investigation was a Mr Graeme Shelley, a trader in Novum Securities, a London-based stockbroker. Julian Rifat was a trader at Moore Capital, a Mayfair hedge fund, and Paul Milson was an equities trader at Legal & General plc.[233] What both Rifat and Milson had in common was that by virtue of their positions they routinely came into possession of inside information about possible mergers, acquisitions, etc. Both Rifat and Milson would pass this insider information to Shelley, who on this basis made transactions and trades to capitalize on the market momentum yet to be generated.[234] The three made a profit of approximately £1 million on the basis of their abusive actions. Insider dealing is usually hard to spot, with no clear indications or signs as to guilt. In the case of Graeme Shelley, information/tips were passed using unnamed/unregistered mobile phones (by one of the traders) and by meetings in person in city pubs. Mr Shelley divided the proceeds of the abusive trades, sharing half of them with the individual providing the information/tips. This half was transferred sometimes in cash instalments of £10,000 in person at the pub meetings (it is pertinent to mention at this point that *tabernula* means ‘little pub’ in Latin) and on other occasions as gifts (he bought Rifat a £50,000 Range Rover and a £15,000 holiday in Oman).[235]

Investigating and proving insider dealing is no easy task, and the FCA had to divert massive resources to the investigation. As a result of numerous man-hours and 143

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[231] David N. Kirk, ‘Going inside for insider trading’ 11 September 2014 <http://www.lexology.com/library/detail.aspx?g=e3c3a268-85cc-4030-9207-ab5f7575b964> accessed 25 October 2015.
[232] Helia Ebrahimi, Ex-hedge fund trader Rifat faces insider charges, 10 January 2014 <http://www.cnbc.com/2014/01/10/> accessed 25 October 2015.
[233] Patton (n213).
[234] Tuckley and Paget-Brown (n213).
[235] Caroline Binham, Caroline Binham, ‘US poised to charge high-profile figure after Julian Rifat deal’ *Financial Times* (London, 19 March 2015) <http://www.ft.com/cms/s/0/74a85e4e-cd91-11e4-8760-00144feab7de.html#axzz3r1BAfa6o> accessed 25 October 2015; James Titcomb, ‘Operation Tabernula: The story of the biggest insider trading investigation in UK history’ *The Telegraph News* (London, 19 March 2015) <http://www.telegraph.co.uk/finance/financial-crime/11483111/Operation-Tabernula-The-story-of-the-biggest-insider-trading-investigation-in-UK-history.html> accessed 25 October 2015.

officials involved in almost a dozen dawn raids, useful information leading to the Shelley-Rifat-Milson discovery was found.[236] All three admitted to participating in insider dealing. The proceeds of the abusive acts were confiscated, they were fined and sentenced. Operation Tabernula resulted in almost ten high-profile insider dealing convictions.[237]

5.7.5 Damian Clarke

Damian Clarke was an equities trader at Schroders Plc. Mr Clarke was charged with nine counts of insider dealing between October 2003 and November 2012.[238] The charges against him included trading in companies including software maker Autonomy Corp, homebuilder Swan Hill Group Plc., and plumbing and heating provider BSS Group Plc.[239] Mr Clarke was arrested in early 2003, and after pleading not guilty in the magistrates' court is currently awaiting a six-week trial scheduled for 2016.[240] Mr Clarke was charged with the criminal offence of insider dealing under section 52(1) of the Criminal Justice Act 1993, instead of the civil offence under section 118 of the FSMA 2000.[241] The case of Damian Clarke demonstrates the new approach of the FCA (after the 2007–08 financial crisis and the LIBOR scandal), which involves in-depth scrutiny of individual traders and bringing criminal prosecutions against them in order to set an example.[242]

5.8 Conclusion

Just as financial markets are constantly developing, with new innovations frequently being introduced, market abuse too is constantly evolving. Now that the dangers of market abuse are universally accepted, regulatory and prohibitive practices need to keep pace with its fast development. The civil market abuse law in the UK is

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236 Ebrahimi (n232).
237 ibid.
238 Martin Sandler, Michael Brown, Peter Willis and Elizabeth Clay, 'Market abuse 2014' 118(Aug) Compliance Officer Bulletin 30–37.
239 S Ring, 'Ex-Schroders Trader Pleads Not Guilty to Insider Dealing' (Bloomberg Business, 24 October 2014) <http://www.bloomberg.com/news/articles/2014-10-24/ex-schroders-trader-pleads-not-guilty-to-insider-dealing-1-> accessed 25 October 2015.
240 ibid.
241 Criminal Justice Act 1993, s52 (1); FSMA 2000, s118.
242 Financial Conduct Authority, Former equities trader charged with insider dealing, 25 June 2014 <http://www.fca.org.uk/news/former-equities-trader-charged-insider-dealing> accessed 26 October 2015.

contained in section 118 of the FSMA 2000. This was amended when the MAD came into effect; now the law might need to be amended again when the MAR takes effect in 2016.[243] The FSMA 2000 has also been amended by the FSA 2012 to incorporate criminal offences relating to market abuse. In the global village, market abuse is being fought collectively as well as individually.[244] Collectively the EU's measures, in the form of the MAD and the MAR (as well as various other laws), aiming to help all the regulators in EU markets, work together in unison. Individually they have aimed to strengthen individual regulators such as the FCA, and to encourage them to pursue criminal and/or civil regimes against persons involved in market abuse. These measures are a necessity, as both at national and European level, instances such as the LIBOR scandal demonstrate how even complex and well-regulated markets are susceptible to collusion and other manipulative practices. This provides a valuable lesson to regulators of developing markets by demonstrating how regulation of markets is not a one-time effort involving the enactment of laws, but requires constant and rigorous efforts to fight off elements that wish to exploit the market for their own motives.[245] Further, going deeper into the study the following chapter will be based on comparative study of the marketing manipulation in the three regimes (Saudi Arabia, US, UK) and Islamic law.

[243] Sandler, Brown, Willis and Clay (n238).
[244] Kern Alexander, 'Insider Dealing and Market Abuse: The Financial Services Act' (FSMA) 2000 (ESRC Centre for Business Research, Cambridge University2000) Working Paper 222,19-20; Janet Austin, 'Unusual Trade Or Market Manipulation? How Market Abuse Is Detected By Securities Regulators, Trading Venues and Self-Regulatory Organizations' (2015)1 (2) Journal of Financial Regulation, 1, 272-273; *Financial Conduct Authority Report*, 'How we enforce the law' < http://www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law> accessed 26 October 2015.
[245] Stephen M Bainbridge, *Research Handbook on Insider Trading* (Edward Elgar 2013) 432–35.

CHAPTER 6: COMPARING THE LAW RELATED TO MARKET MANIPULATION IN US, UK, SAUDI ARABIA AND ISLAMIC LAW

6.1 Introduction

This chapter focuses on comparing the laws of market manipulation of Saudi Arabia, the US, the UK and under Islamic law. It begins by explaining the prevalent law of market manipulation and insider trading in all the above-mentioned regimes. Individual elements of the law or its regulation are then discussed and compared. The civil regime of law and regulation in matters of market manipulation and insider trading has proven to be significantly more important, hence will be given greater attention in this chapter. It is also pertinent to mention that material on the Islamic law of market manipulation and insider trading is scarce, hence reference to Islamic law has required deductions to be made from the original sources.

6.2 Saudi Arabia

Saudi Arabian law on capital markets is still in its nascent stages, with legislation only recently introduced. The primary legislation regulating capital markets is the Capital Market Law in 2003; this was supplemented by the Market Conduct Regulation issued in 2004.[1] Under article 49 of the Capital Market Law it is prohibited for any individual to intentionally commit any action which creates a 'false or misleading impression' as to the price of any security or the market; or to induce third parties to either buy, sell or subscribe for such security (or exercising or refraining from exercising any rights under such securities), or to refrain from doing so.[2] Article 49(c) further lists practices which would be considered market manipulation under the Capital Market Law. These include to create a false or misleading impression of trading activity of a particular security, using transactions to create an actual or apparent trading activity on particular stock influencing its price and inducing third parties to trade in it, and using transactions for pegging or stabilization of prices.[3] To provide greater insight the Capital Market Authority

[1] Aljazira Capital, 'The Financing Role of the Saudi Capital Market: Promising Prospects' (2010) Research Department, Economic Reports 1.
[2] CML 2003, art49.
[3] CML 2003, art49(c).

formulated the Market Conduct Regulations, to be read in conjunction with and elaborating upon the Capital Market Law. Article 2 of the Market Conduct Regulations prohibits any manipulative or deceptive acts or practices and article 3 lists some of the actions that would be considered manipulative and deceptive.[4] Article 3 divides these acts broadly into two groups: the first group[5] on acts considered manipulative and deceptive, and the second[6] those which would be considered manipulative or deceptive when committed for the purpose of creating a false or misleading impression of trading activity in relation to a security or to manufacture an artificial price, etc.[7]

Article 50 of the Capital Market Law prohibits any insider[8] from directly or indirectly trading in the securities to which the said information relates. Furthermore article 50(b) also prohibits any person who comes into possession of insider information, from dealing in that security provided the person who has received the information is aware that it is in violation of article 50(a).[9] Article 50 is elaborated upon by articles 4 to 6 of the Market Conduct Regulation. Article 4 further clarifies how the law will operate, specifying who would be considered an 'insider', who shall be considered directly or indirectly trading in a security. The article also clarifies what would constitute insider information for the purposes of the MCR.[10] Article 4(c) defines insider information as information related to a security which is not available to the public, and imposes the test that a normal person would realize that its disclosure to the public would have a material effect on the price of such security.[11] Article 5 places a prohibition on both an insider and a person in possession of inside information from disclosing it if 'they knew or should have known' that the recipient might trade in the affected security.[12]

[4] MCR, arts 2 and 3.
[5] ibid art 3(1).
[6] ibid art 3(b).
[7] ibid.
[8] A person who is in possession of 'inside information' that is information not publicly available but in possession of the insider by virtue of any contractual, personal, or employment relationship.
[9] CML, arts50(a) and (b).
[10] MCR, art4.
[11] ibid art4(c).
[12] MCR, art5.

6.3 Islamic Law

The Islamic law practised today came into being over 1400 years ago.[13] The primary sources of this law are the Holy Qur'an and the Sunnah (the actions of the Prophet Muhammad (peace be upon him)).[14] The first company the Dutch East India Company, was given a royal charter in 1601, that is almost a thousand years after the coming of primary Islamic law. As such, at the time of its coming Islamic law had no need for and thus did not expressly provide any law prohibiting or regulating market manipulation and/or insider trading. However anticipating the need for the law to keep up with the times, Islamic law has provided multiple sources of law including *Ijma* (consensus of the community of Islamic scholars), *Ijtihad* (the reasoning of an Islamic scholar) and *Qiyas* (ability of each individual to apply his own reasoning to find the solution to a particular dilemma). Using the secondary sources, four primary schools of jurisprudence have been developed, namely Hanafi, Hanbali, Shafi and Maliki. Islamic law in its pure form, is not seen in practice today. What is seen is that wherever Islam was introduced in the past, Islamic law merged with the indigenous law of the land. This produced a hybrid system of law with certain aspects influenced by Islamic law and the rest by indigenous law.[15]

Although the Holy Qur'an and the Sunnah are silent on the issues of 'market manipulation' and 'insider trading', they do provide Fundamental Principles which can be interpreted and applied, as well as to numerous other areas today. For example a fundamental principle of Islamic law is that contracts must be upheld, Surat Al-Ma'idah says, 'O you who believe! Fulfil your undertakings'.[16] Another example is the Prophet Muhammad (peace be upon him) instructing a trader of his duty to disclose any fault in his product himself to any prospective buyers, so as not to deceive them and to be fair in his dealings (this is in contradistinction to the English principle of *caveat emptor*). Islamic Law sets a framework for a thriving

[13] Mustafa Alzarqa, *Almadkhal Al-Fighi Alaam* (Arabic edition, Dar Al-Qalm Publisher, Damascus) 49-50; Noel J Coulson, *A History of Islamic Law* (University Press 1964) 9–10; H. Patrick Glenn, *Legal Traditions of The World* (Oxford University Press 2000) 180.
[14] Mū'il Yūsuf 'Izz al-Dīn, *Islamic Law* (University of Notre Dame Press 2005) 37; Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence* (Islamic Texts Society 2003) 18.
[15] As mentioned before in chapter 5.
[16] Holy Qur'an, Surat Al-Ma'idah (5) Ayah 1, (King Fahd Complex for the Printing of the Holy Qur'an).

economy and lays down rules as well as guidance in all aspects of commercial dealings. For example, Surat Al-Baqarah of the Qur'an clarifies:[17]

> O you who believe! When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you … You should not become weary to write your contract, whether it is small or big, for its fixed term. That is more just with Allah, more solid as evidence, and more convenient to prevent doubts among yourselves…take witnesses whenever you make a commercial contract.

Not only does the verse instruct that all contracts should be written, even 1400 years ago it was pragmatic enough to require that witnesses be present in commercial contracts. To fully understand how Islamic law would apply to instances of market abuse we would interpret some of the fundamental values under it. These fundamental values are:

(1) Honesty:

In Surat Al-Baqarah of the Qur'an states:[18]

> 'mix not the truth with falsehood, nor conceal the truth while you know (the truth).'

(2) Trust and Trustworthiness:

Emphasized in Surat Al-Anfal of the Qur'an which is translated thus:[19]

> 'O you who believe! Betray not Allah and His Messenger (peace be upon him), nor betray knowingly your *Amanat* [the things entrusted to you]'

Additionally in a Hadith narrated by Abu Hurairah, it was reported that the Prophet Muhammad (peace be upon him) said: 'The signs of the hypocrites are three: when

[17] Holy Qur'an, Surat Al-Baqarah (2), Ayah 282, (n16).
[18] Holy Qur'an, Surat Al-Baqarah (2), Ayah 42, (n16).
[19] Holy Qur'an, Surat Al-Anfal (8), Ayah 27, (n16).

he speaks, he lies; when he makes a promise, he breaks it; and when he is charged with a trust, he violates the trust.' [20]

(3) Justice:

Islamic law emphasizes justice in all dealings, and this can be seen by Surat Al-A'raf of the Qur'an which is translated thus:[21]

Say O Muhammad (peace be upon him): My Lord has commanded justice'.

Furthermore, Surat an-Nisa of the Qur'an is translated thus:[22]

O you who believe! Eat up not your property among yourselves unjustly'

Surat Al-Nisa of the Qur'an which is translated thus:[23]

… their devouring of men's substance wrongfully. And We have prepared for the disbelievers among them a painful torment.'

In 'insider trading', a particular individual uses 'material' knowledge about shares unfairly, to make a profit in the market at the expense of unsuspecting individuals, who rely on the fair natural operation of the market. As such the individual committing the 'insider trading' breaches a duty of trust owed to the other users of the market, dishonestly circumventing fair trading practice, in effect stealing. The Prophet (peace be upon him) said about '*souht*' (meaning ill-gotten or unlawfully obtained property), 'any activity built from *souht*, will be cast into fire'.[24] Furthermore it is so disliked that Islamic law even forbids using '*souht*' from being given as alms or charity, the Prophet (peace be upon him) said, '*Sadakah* [donations that] come from theft are not acceptable'.[25]

As discussed earlier, market manipulation is the act of creating a false or deceptive image of the market or a security inducing a third party to buy or sell as a result of

[20] Narrated by El –Bukhari, Hadith number: 33, (Darussalaam for Publication and Distribution 1999).
[21] Holy Qur'an, Surat Al-A'raf (7), Ayah 29, (n 16).
[22] Holy Qur'an, Surat an-Nisa (4), Ayah 29, (n 16).
[23] Holy Qur'an, Surat an-Nisa (4), Ayah 161, (n 16).
[24] Narrated by Al-Tirmidhi, Hadith number: 614, (Darussalaam for Publication and Distribution 1999). After this Hadith Imam Altirmidhi said this Hadith is Hassan. Also Shaykh al-Albaani said this Hadith is Saheh (Saheh Al-Tirmidhi).
[25] ibid.

whose loss the market manipulator makes a profit. Thus market manipulation is in violation of both honesty, since the manipulative act itself is dishonest, and trustworthiness, since rather than promoting mutual trust, the deceptive behaviour would directly weaken it. The Holy Qur'an in Surat Al-Baqarah states:[26]

> And do not swallow up your property among yourselves by false means, neither seek to gain access thereby to the judges, so that you may swallow up a part of the property of men wrongfully while you know.

The verse expressly prohibits the using of any false means to 'swallow', meaning knowingly usurp the property belonging to another. Furthermore the Prophet Muhammad (peace be upon him) said: 'He who deceives is not of me' or 'He who deceives us is not of us', in essence banishing and punishing those who deceive.[27]

Applying these Islamic principles to the trading of securities we can see that (1) transactions of securities are meant to be binding; (2) Islamic law requires full disclosure of all information related to the securities being traded; and (3) natural market forces should be allowed to fairly determine price outcomes. These Islamic principles completely prohibit any fraudulent, manipulative or deceptive activities in relation to any trade (expanded to include any trade in securities). In light of the above, Islamic law prohibits all activities of and in relation to market manipulation and insider trading.[28]

6.4 The US

A smooth-running free economy based on natural market principles is the backbone of any thriving economy. This keeps investor confidence high and thus favours investment and trade. Insider trading and market manipulation artificially stimulate the market, resulting in a manufactured price. The dangers of an unregulated market where market manipulation and insider trading were rampant first came to light in the US during the Wall Street crash of 1929.[29] To prevent a repeat occurrence of a

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[26] Holy Qur'an, Surat Al-Baqarah (2), Ayah 188, (n 16).
[27] Narrated by Muslim, Hadith number: 181, (Darussalaam for Publication and Distribution 1999).
[28] Zahr Aldeen Abdulrahman, *Maqasid al-Shariah Fi Ahkam al-Boya* (Dar Alkutub Alelmyah, 2009)
[29] Jerry W. Markham, 'Manipulation of Commodity Futures Prices–The Unprosecutable Crime' (1991) 8(2) Yale Journal on Regulation, 281, 305; United States. Grain Futures Administration,

disaster of the same magnitude and to prevent abusive market behaviour like market manipulation and insider trading, it was essential to implement a set of new laws to combat them. It was understood and accepted that the prevention of such dangers is contingent upon enacting and enforcing proscribing legislation. Accordingly the two securities acts, the Securities Act 1933 and the Securities and Exchange Act 1934 were enacted.[30]

The Securities Act 1933 regulates the initial offering of securities to the public by imposing registration requirements on companies.[31] By doing so, potential investors/buyers gain valuable insight into any company whose securities are going to be offered for initial sale. This includes details with regard to its financial standing etc, and this disclosure acts as a safeguard against deception, fraud and misrepresentation in the sale.[32] The Securities and Exchange Act 1934 created the Securities and Exchange Commission, the apex civil regulator of securities matters and secondary financial markets. All traded securities must be registered with the Securities and Exchange Commission, and every company issuing shares must comply with the SEC's information and document filing requirements.[33] The Securities and Exchange Act 1934 is the primary and oldest law on market manipulation and insider trading in the US. Section 9 of the Securities and Exchange Act 1934 prohibits the direct or indirect use of any means, instruments, etc to create a false or misleading impression as to the market for a security, or its trading activity etc. Section 9 thus gives a list of acts which it deems to be manipulative; additionally, it also provides broad categories of the behaviour which would be construed as abusing the market. Section 9(a)(3) prohibits insider dealing, forbidding the act of 'circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations' inducing the purchase or sale of any related

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Annual Report of the Chief of the Grain Futures Administration, (Washington, D.C. : U.S. Dept. of Agriculture, Grain Futures Administration) 1934 (3–4).

[30] Marshall, W. Taylor, 'Securities law – the Securities Exchange Act of 1934 - 'round and 'round we go: the Supreme Court again limits the circumstances in which federal courts may hold secondary actors liable under section 10 and SEC Rule 10B-5 ' (2008) 1University of Arkansas at Little Rock Law Review 1, 196–197.

[31] TC Newkirk, 'The Advantages of a Dual System: Parallel Streams of Civil and Criminal Enforcement of the U. S. Securities Laws, speech by SEC Staff (date unknown).

[32] R Söderström, 'Regulating Market Manipulation: An Approach to Designing Regulatory Principles' (Uppsala Faculty of Law Working Paper 2011) 11.

[33] Newkirk (n 31).

security. Section 9 expressly targets stock brokers who routinely trade in securities and gives investors the right to bring an action on the basis of trading activity, patterns or trends that paint the image of stock doing better or worse than it actually is, as these activities go against natural market principles and manufacture a false image of the market.[34] Section 10(a) prohibits the making of 'short sales'[35] or 'stop loss orders'[36] where the Securities and Exchange Commission has promulgated any rules or regulations prohibiting it. Sections 9 and 10(a) list a number of behaviours which would be illegal under the Securities and Exchange Act 1934. However, in the fast-paced and rapidly evolving world of the securities market it is very important for the law to be quickly updated, and delay in legislation being passed by parliamentary procedures becomes harmful. From the construction of section 10(b) it appears it was drafted keeping in mind this very purpose. Under Section 10(b) it is unlawful for any person to use any manipulative or deceptive means, in violation of any rules or regulations the Securities and Exchange Commission may prescribe. Section 10(b) is a blanket catch-all provision; any manipulative or deceptive behaviour not caught by any of the other clauses can still be caught by section 10 (b). Additionally section 10(b) expressly recognizes the power conferred upon the Securities and Exchange Commission to make rules in this regard.[37]

Under section 10(b) the Securities and Exchange Commission incorporated rule 10b-5 'Employment of Manipulative & Deceptive Devices', which hand in hand with section 10 works to further limit manipulative and abusive behaviour. Rule 10b-5 prohibits in relation to any security the use of any 'device, scheme, artifice'[38] to defraud, the making of any false statement of 'material' fact and any act or behaviour which would operate as 'fraud or deceit' upon any person. Rule 10b-5 was drafted very widely with words like 'any device, scheme' to defraud or to commit any act or behaviour which 'operates as fraud or deceit', giving the Securities and

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[34] Deepa Sarkar, 'Securities Exchange Act of 1934' (Cornell Law School Securities Law Clinic) <https://www.law.cornell.edu/wex/securities_exchange_act_of_1934> accessed 7 April 2015.

[35] Short sale: Securities. A sale of a security that the seller does not own or has not contracted for at the time of sale, and that the seller must borrow to make delivery: *Black's Law Dictionary* (9th edn West 2009) 1456.

[36] Stop order. An order to buy or sell when the security's price reaches a specified level (the *stop price)* on the market. By fixing the price beforehand, the investor is cushioned against stock fluctuations, Black's Law Dictionary (9th edn West) 1208.

[3737] Edward A. Fallone, ' Section 10(B) and the vagaries of federal common law: The merits of codifying the private cause of action under a structuralist approach' (1997) 1 University of Illinois Law Review 1, 71–72.

[38] Rule 10b5(a) of the Securities and Exchange Commission.

Exchange Commission the authority to classify virtually any manipulative behaviour as abusive. Additionally the Securities and Exchange Commission issued rule 10b5-1 covering trading on the basis of Material Non-public Information in Insider Trading Cases. Rule 10b5-1 adds to the existing category of 'manipulative and deceptive devices' proscribed by section 10(b) of the Securities and Exchange Act 1934 and rule 10b-5. It prohibits the buying or selling of a security on the 'basis of material non-public information' in breach of a duty of trust owed to the issuer of the security or any other individual who is the source of the 'material non-public information'. Rule 10b5-1 further describes 'on the basis of' as being when the individual trading in the security was aware of the 'material non-public information' at the time of making of the trade.[39]

But the US endeavour of further improving securities regulation and reducing fraudulent and manipulative activities did not stop with the Securities Acts. The Sarbanes-Oxley Act was introduced in 2002 by President Bush as the 'most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt'.[40] The Act increases penalties (both civil and criminal) for securities violations thus aiming to improve corporate disclosures, financial reporting and audits (it creates the 'Public Company Accounting Oversight Board').[41] This was followed by the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 under President Obama, which aimed to reshape the US securities regulatory system on *inter alia* consumer protection, regulation of financial products, corporate governance and to combat corporate and accounting fraud.[42]

6.5 The UK

In the UK, market manipulation and insider trading were originally prosecuted under the Theft Act 1968.[43] These sections have been repealed and insider trading is now

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[39] Rule 10b5–1 of the Securities and Exchange Commission.
[40] Official website of the SEC <http://www.sec.gov/about/laws.shtml> accessed 29 November 2015.
[41] Söderström (n 32).
[42] E. F. Greene, 'Dodd-Frank: A Lesson In Decision Avoidance' (2011) 6(1) Capital Markets Law Journal, 1, 29-30; D. S. Evans, H. Chang and S. Joyce, 'The Impact of the U.S. Debit-Card Interchange Fee Regulation on Consumer Welfare' (2015) 11 Journal of Competition Law and Economics 1,1–2.
[43] D. C Ormerod and others, *Smith and Hogan's Criminal Law* (Oxford University Press 2011) ch26.

dealt with by section 52 of the Criminal Justice Act 1993.[44] Major reform in this area was accomplished by the passing of the Financial Services Act 1986 which was replaced in 2000 by the Financial Services and Markets Act, itself later amended by the Financial Services Act 2012. This is currently the primary piece of legislation governing market manipulation and insider trading in the UK. Section 118 of the Act creates the category of 'Market Abuse', which includes both market manipulation and insider trading.[45]

For a person to be guilty of 'market abuse' (market manipulation and/or insider trading) in the UK he must fulfil all three requirements of section 118 which are, first that the behaviour has to be in relation to 'qualifying investments',[46] second that one of the three conditions mentioned in section 118(2) is met,[47] and thirdly that the suspect behaviour 'is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.'[48] As such the test laid by section 118(c) is objective in that the accused's own mental element at the time is not important, rather what is important whether a reasonable user of the market would construe the behaviour as falling below the standard of a reasonable person. The conditions mentioned in section 118(2) are that: the behaviour in question is based on insider information not available publicly; the behaviour is likely to give the regular user a false or misleading impression as to demand, supply or price of securities; and the behaviour in question would be regarded by a regular user of the market as the type of behaviour which would or is likely to distort the market. Section 118 further sets the standard as the doing of any act which fails to pass the standard considered by a regular user of the market as falling below the standard of behaviour reasonably expected of a person in his position.

The UK joined what was later to become the European Union in 1973.[49] With capital markets rising throughout Europe, the EU made moves towards greater

[44] Act 1993, s52.
[45] Financial Services and Markets Act 2000, s 118.
[46] ibid s 118(a).
[47] ibid s 118(b).
[48] ibid s 118(c).
[49] Kristine Mitchell, 'The European Trade Union Confederation At 40: Integration And Diversity In The European Labor Movement' (2014) 55 (4) Labor History 403.

standardization and increasing protection so as to strengthen these markets. To achieve this end the European Parliament issued Directive 2003/6/EC on 28 January 2003 covering 'Market Abuse' (which includes both market manipulation and insider Trading).[50] Under EU law it is mandatory for member states to implement Directives. The UK transposed the Market Abuse Directive (MAD) into domestic law via the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005, the Investment Recommendation (Media) Regulations 2005, Financial Services Authority 2005/15 – Market Abuse Directive Instrument 2005 and Financial Services Authority 2005/16 – Market Abuse Directive (Disclosure Rules) Instrument 2005.[51]

Under article 2 of MAD, market manipulation is defined as transactions and orders which give a false signal of supply, demand or price of a security; which create an artificial price; or as transactions employing fictitious devices or deception and dissemination of false information (where they know or ought to know that the information is false) leading to a misleading impression.[52] The Directive lists certain examples of what would constitute market manipulation as defined in article 1(2).[53]

6.6 Overview

The securities market is constantly in flux, with frequent new developments made in substance and procedure. As such, the law is posed with the difficulty of creating a standardized definition which is sufficiently specific as this specificity would act as a limitation, restricting the definition from applying to new scenarios. This concern becomes more important when it comes to formulating exact definitions for market manipulation and insider trading. This is felt when observing the law on market manipulation and insider trading incorporated by the legal regimes discussed here (US law, UK law, Saudi Arabian law, Islamic law). The US law on the matter

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[50] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJ L 96, 12 April 2003, 16; Clifford Chance, 'The European Union Market Abuse Directive' (2003) 9(1) Journal of Derivatives and Hedge Funds, 1, 84; Ferrarini, GA, 'The European Market Abuse Directive' (2004) 41(3) Common Market Law Review, 631, 716.
[51] Jonathan Marsh, 'UK Legal And Regulatory Developments: Implementation Of The Market Abuse Directive' (2005) 11(2) Derivatives Use Trading & Regulation 104, 175-176.
[52] MAD 2003, art2.
[53] ibid art1(2).

contained primarily in section 9 of the Securities and Exchange Act 1934 fails to give a definition of market manipulation or insider trading; rather it gives generalized circumstances (drafted very broadly) which would constitute Market Manipulation or Insider Trading.[54] The UK law on market manipulation and insider trading (collectively referred to as 'market abuse' by the Financial Services and Markets Act 2000) is primarily contained in section 118 of that Act .[55] Section 118 is supplemented and further elaborated upon by the Code of Market Conduct (MAR 1) given by the Financial Conduct Authority, which gives further details as to the conducts constituting market abuse given in section 118. The Saudi legislation too fails to give an express definition; however, like US law it mentions behaviour that would be classified as abusive.[56]

Both the UK and the US operate dual (civil and criminal) regimes in dealing with Market Manipulation and Insider Trading. For example in the UK, section 118 along with the Code of Conduct covers civil prosecutions whereas, section 397 of the Financial Services and Markets Act 2000 deals with criminal prosecutions.[57] In US law on the other hand both civil and criminal prosecutions may be brought under section 9 of the Securities and Exchange Act 1934.[58] Furthermore in the US civil proceedings are brought by the Securities and Exchange Commission whereas criminal cases are prosecuted by the Department of Justice. In the UK the Financial Conduct Authority is empowered by the Financial Services Act 2012 to bring both civil and criminal proceedings.[59]

Historically most of the proceedings for Market Manipulation and Insider Trading in the UK were criminal in nature, and due to the higher standard of burden and the added requirement of proving a mental element, few prosecutions bore fruit. This approach was altered with time, significantly affected by the influence of the European Union which was working towards a single market. Market manipulation

[54] Securities and Exchange Act 1934, s9.
[55] Financial Services and Markets Act 2000, s118.
[56] Saudi Capital Market Law Act 2003, art49.
[57] Financial Services and Markets Act 2000, s118 and s397.
[58] Securities and Exchange Act 1934, s9.
[59] Financial Services Act 2012.

and insider trading are characterized differently in the US and the UK with the former viewing it as criminal conduct and the latter as a regulatory offence.[60]

6.7 Who Can Sue?

Whenever market manipulation, insider trading or any other securities fraud takes place, a number of parties are affected. There is always a buyer and a seller between whom there is a contract for sale and purchase of a particular security. The abusive behaviour results in one of the two (the buyer or the seller) gaining at the expense of the other. If normal market behaviour were allowed to take its course this would have been acceptable but the artificially manufactured appearance which led to the contract under false pretences constitutes deception, and as mentioned earlier leads to investors losing their confidence in the market. Once information of the abuse comes to light, the civil and/or criminal regulatory authorities start investigating the matter. While regulatory authorities such as the Securities and Exchange Commission and the Financial Conduct Authority have the power to compensate those victims of market manipulation and insider trading under their powers of disgorgement and restitution respectively (we will discuss these powers later in greater detail), on many occasions it is more expedient and efficient for those affected to bring litigation proceedings themselves.

As a starting point, regulatory authorities are always authorized by law to bring proceedings; in the US the Securities and Exchange Commission is authorized by the Securities and Exchange Act 1934,[61] in the UK the Financial Conduct Authority by the Financial Services and Markets Act 2000,[62] in Saudi Arabia the Capital Market Authority by the Capital Market Law[63] and under Islamic law, the institution of the Caliphate. However the primary aim of regulatory authorities is to stop abusive behaviour, not to get compensation for the victims of the abuse. Additionally there

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[60] Shearman and Sterling LLP, Financial Institutions Advisory and Financial Regulatory, 'The UK and US Market Abuse Divide: The Winterflood Appeal and Other Developments (25 June 2010) <http://www.shearman.com/~/media/Files/NewsInsights/Publications/2010/06/The-UK-and-the-US-Market-Abuse-Divide-the-Winter__/Files/View-full-memo-The-UK-and-the-US-Market-Abuse-Di__/FileAttachment/FIA062510TheUKandUSMarketAbuseDivide.pdf> accessed 29 November 2015.

[61] Securities and Exchange Act 1934.

[62] Financial Services and Markets Act 2000.

[63] Saudi Capital Market Law Act 2003.

are other considerations, for example regulatory authorities usually have limited resources, which means that they cannot prosecute every potential instance that might come to their notice and have to prioritize by devoting resources to cases which are either higher profile, or have a higher chance of success. If the victims in these cases want to be compensated they have no choice but to bring legal proceedings on their own. However not everyone who wants to bring a legal action is allowed to do so by the court. Each jurisdiction has laws in place which restrict the type of people and the instances in which they have the right to bring a legal action in cases of securities law violations.

In the UK under section 71 of the Financial Services and Markets Act 2000 where there is a violation of sections 56(6), 59(1) or 59(2) a private person who has suffered loss as a result has the right to bring a suit.[64] Under section 150 of the Financial Services and Markets Act 2000 where there is a contravention of rules, any private person who has suffered a loss as a result of the behaviour in violation can bring a private action for compensation.[65] It is pertinent to note however that section 150 only applies where there has been a violation of rules (not statute) such as the MAR.[66] Since the MAR covers a number of matters, including multiple forms of market manipulation and insider trading, under section 150 potentially most private individuals who have suffered loss as a result of the violation of market manipulation or insider trading, can bring a private legal action against the violator. The Financial Services and Markets Act 2000 was amended by the Financial Services Act 2012 adding section 138D, which states that where there is a violation of a rule made by the Financial Conduct Authority, the person who has suffered a loss may bring a private legal action against the individual in breach (section 138D also states that where a rule has been made by the Prudential Regulation Authority the rule may itself allow that a private legal action be brought on its behalf).[67] Originally under section 150 (of the FSMA 2000) and later section 138 D (introduced by the FSA in 2012) where there was a breach of rules only those individuals who had themselves suffered a loss had the right to bring legal proceedings. While these individuals had the right of private legal action they seldom had the resources to undertake lengthy

[64] Financial Services and Markets Act 2000, s71, 56(6), 59(1) and 59(2).
[65] Financial Services and Markets Act 2000, s150.
[66] ibid.
[67] Financial Services Act 2012, s138D.

and expensive legal battles, thus failed to benefit from it. In a landmark ruling the High Court in *Connaught Income Fund, Series 1 v Capita Financial Managers Ltd* [68] decided that private individuals had the right under section 138 D to assign their right of private legal action to another. In this way individuals who could not avail their right directly can now get redress indirectly.[69] Third parties such as hedge funds and litigation funders can purchase the claim of an individual as an investment (possibly multiple individuals combining them together) and then exercise the private legal right themselves on the basis of their ample and much greater resources, against much larger defendants (such as financial institutions, stock brokers, etc).[70]

In the US the need to provide private parties with the right to legal action was originally recognized by legislature in a limited manner. Section 9(f) of the Securities and Exchange Act 1934 states that any person who has suffered a loss as a result of a violation of sections 9(a), (b) or (c) *has the right to bring a pr*ivate legal action against the individual in violation.[71] It is pertinent to note that sections 9(a), (b) and (c) list a limited number of instances which are considered market manipulation, there are various instances of market abuse where private persons suffer losses which do not fall under the scope of sections 9(a), (b) or (c). Section 9(f) *does not give these individuals the right to bring a private legal action.* Under section 16(b) of the Securities and Exchange Act 1934 where a beneficial owner, director or an officer has made a profit by virtue of having an unfair advantage of information gained by their relationship with the issuer, the issuer or the owner of the security of the issuer may bring a legal action for recovery (pertinent to note that this is a right given to the issuer and thus is not the right to a private legal action). The Securities and Exchange Act 1934 is silent as to whether there is private right to action under section 10(b) (the much wider provision than section 9 encompassing far more instances of market manipulation as well as insider trading).[72] However despite the Securities and Exchange Act's silence it has become accepted practice

[68] *Connaught Income Fund, Series 1 v Capita Financial Managers Ltd and anr* [2014] EWHC 3619 (Comm).
[69] Financial Services Act 2012, s138D.
[70] Allen and Overy, 'Top Ten Finance Litigation and Regulatory Decisions of 2014' <http://www.allenovery.com/publications/en-gb/Pages/Top-Ten-Finance-Litigation-And-Regulatory-Decisions-Of-2014.aspx> accessed 29 November 2015.
[71] Securities and Exchange Act 1934, s9(a), (b), (c) and (f).
[72] ibid s9 and 10(b).

that there is a private legal right under section 10(b) and rule 10b-5.[73] In *Ernst & Ernst v Hochfelder*,[74] Justice Powell opined: 'Although section 10(b) does not by its terms create an express civil remedy for its violation, and there is no indication that Congress or the Commission [SEC] when adopting Rule 10b-5 contemplated such a remedy, the existence of a private cause of action for violations of the statute and the Rule is now well established'.[75] For an individual (or the Securities and Exchange Commission) to bring a successful legal action they must prove four essentials: (1) the existence of manipulation or deception; (2) said manipulation or deception was 'material'; (3) said manipulation or deception was in relation to the buying or selling of securities; and (4) *scienter*.[76] In an effort to reform private securities litigation Congress passed the Private Securities Litigation Reform Act 1995, which sought to end frivolous or weak claims by litigants. The most prominent way the Private Securities Litigation Reform Act 1995 attempts to do this is by imposing additional criteria before a suit can be filed and by introducing a new method for calculation of 'actual' damages.[77]

The Saudi Arabia securities law despite being newly created has multiple provisions giving private persons the right to bring legal proceedings.[78] Article 55 of the Capital Market Law states that where an individual has purchased securities based on a prospectus containing a false statement hence suffering a loss the individual has a right to bring a legal action.[79] Under article 55 the private legal right can be exercised against only a select few individuals, the more prominent of which are the party issuing the security, senior officers of the issuing party, and members of the Board of Directors.[80] Hence article 55 does not necessarily require a purchaser–seller relationship nor privity of contract.[81] The article further also lists certain defences to be available to those accused of being in violation. While article 55 was limited to

[73] ibid s10b-5.
[74] *Ernst & Ernst v Hochfelder* 425 US 185 (1976).
[75] Securities and Exchange Act 1934, s10b-5.
[76] R Girasa, *Corporate Governance and Finance Law* (Palgrave Macmillan 2013) 183.
[77] Private Securities Litigation Reform Act 1995; Lee, Ho-Young; Mande, Vivek and Son, Myungsoo , 'The Effect of the Private Securities Litigation Reform Act of 1995 on the Cost of Equity Capital' (2009) 48(2) Quarterly Journal of Finance and Accounting 85.
[78] Saudi Capital Market Law Act 2003.
[79] CML, art55.
[80] CML, art 55(b)1,2 and 3.
[81] CML, art 55.

statements made in a prospectus, article 56 has much wider application.[82] Under article 56 the maker of any false statement in regard to any security is liable to any individual who suffers a loss because of it.[83] Not only does article 56 give the right to a private legal action, it also expressly states that there is no requirement for there to be a relationship.[84] Any individual whose behaviour is in violation of article 49 (market manipulation)[85] or any of the rules published in relation to it (articles 2 and 3 of the Market Conduct Regulation)[86] with the aim of manipulating the price will be liable to any individual who has suffered a loss under article 57.[87] Although article 57 creates a private legal right where there has been market manipulation (article 49) the Capital Market Law does not expressly mention that there is any private legal right where the victim has suffered as a result of insider trading (article 50).[88] Article 64 does seem to suggest however that where someone is in violation of article 50 (insider trading) that there might be compensation payable.[89]

Although Islamic law is not definite on the point, under Islamic law those who were affected were always allowed to bring a claim in front of the *Qadi* (judge under Islamic law). It can be thus deduced that Islamic law recognizes that each individual has the right to a legal action. There are several instances where individuals who believed they were wronged by Caliphs[90] brought claims against them, demonstrating that not even the head of state had immunity. Thus applying traditional Islamic law it follows that victims of market abuse (market manipulation and Insider Trading) would be allowed to bring legal action against those committing the market abuse.

6.8 Role of '*Mens Rea*' and 'Requirement of Intent'

From section 9 of the Securities and Exchange Act 1934 in the US to section 118 of the Financial Services and Markets Act 2000 in the UK, to articles 49 and 50 of the

[82] CML, arts 55 and 56.
[83] CML, art 56.
[84] ibid.
[85] CML, art 49.
[86] MCR, arts 2 and 3.
[87] CML, art 57.
[88] CML, arts 49 and 50.
[89] ibid arts 50 and 64.
[90] In the Islamic state the 'Caliph' was the head of the state. The institution of the Caliph succeeded the Prophet Muhammad (peace be upon him).

Capital Market Law in Saudi Arabia and finally Islamic law, market manipulation and insider trading have been prohibited in all four jurisdictions. However in applying the law the standard/test to be satisfied under all three laws appears to be different. In the UK in order to bring a successful claim under section 118 there is no requirement of any 'manipulative intent'.[91] (It is pertinent to add that this is not the case for proceedings under section 397 for the criminal offence of market manipulation where there is a requirement to prove 'manipulative intent'.)[92] In *Winterflood Securities Ltd v Financial Services Authority*,[93] the Court of Appeal shed light on this by opining that 'the test is wholly objective; it does not require any particular state of mind on the part of the person whose behaviour is under consideration.'[94] In contrast, section 9 of the Securities and Exchange Act 1934 is silent as to any mental requirement or the standard to be applied in assessing whether the behaviour constitutes market manipulation or insider trading.[95] However in *Ernst & Ernst v Hochfelder*,[96] the US court held that a private cause of action under section 10(b) will only be available if there is evidence as to the existence of '*scienter*'.[97] Thus reviewing the precedents and decisions of US court's a trend can be observed of the courts requiring that 'manipulative intent' or '*scienter*' be proven for a successful action. *Black's law Dictionary* defines '*scienter*' as: 'A degree of knowledge that makes a person legally responsible for the consequences of his or her act or omission; the fact of an act's having been done knowingly, esp. as a ground for civil damages or criminal punishment.'[98] This US requirement of *scienter* is in complete contrast with UK civil law, in which there is no requirement of proving any mental element (*Winterflood Securities Ltd v Financial Services Authority*[99]).

The law in Saudi Arabia (articles 49 and 50 of the Capital Market Law[100] and articles 2 to 6 of the Market Conduct Regulations[101]) does not expressly mention the existence of any mental element to be proven. However, as in US law the Saudi

[91] Financial Services and Markets Act 2000, s118.
[92] ibid s397.
[93] *Winterflood Securities Ltd v Financial Services Authority* [2010] EWCA Civ 423.
[94] ibid.
[95] Securities and Exchange Act 1934, s9.
[96] *Ernst & Ernst v Hochfelder* 425 US 185 (1976).
[97] Securities and Exchange Act 1934, s10b.
[98] *Black's Law Dictionary* (9th edn West 2009) 1463.
[99] *Winterflood* [2010] EWCA Civ 423.
[100] CML, arts 49 and 50.
[101] MCR, arts 2 and 6.

Arabian courts too in their dicta have laid down the principle that article 49 of the Capital Market Law and articles 2 and 3 of the MCR, contain a 'material' as well as a 'moral' element.[102] The 'material' element is the physical behaviour such as the conducting of a series of transactions, which would create a false impression of active trading and inflate stock price. The 'moral' element is intent of the individual and is satisfied by showing that the person conducting the act is aware of its nature and had the intention of conducting the act that implies manipulation or fraud.[103]

Islamic law is pragmatic and constructed upon reason. To begin with let us observe one of the primary sources of Islamic law the Sunnah. One of the famous Hadith, considered one of the greatest in Islam, narrated by Umar bin Al-Khattab that the Prophet (peace be upon him) said: 'Actions are judged by intentions.'[104] As a starting point it is certain that in judging an action intent plays an important role. Islamic law,like the common law system too has legal principles or maxims. One such prominent maxim is '*al-umur bi maqasidiha*', which implies that any physical act of the wrong doer should be judged by his intention.[105] The first part of the maxim '*umur*' means a physical or verbal act and the second part '*al-maqasid*' means willing or the determination to do something for a purpose.[106] Furthermore, Surah Al-Ahzab no 33 verse 5 states: 'But there is no blame on you if ye make a mistake therein: [what counts is] the intention of your hearts and Allah is Oft-Returning, Most Merciful'. Thus it appears certain that there is a '*mens rea'* or intent requirement in Islamic law. To further clarify what constitutes 'criminal intent' we can take into account the view of Imam Abou Zahra, a prominent Islamic scholar. He states that criminal intent is the intent to act in a wilful, premeditated and deliberate manner, with complete consent as to the intended result.[107] Further intentional crimes must meet three conditions: (1) premeditation; (2) freedom to choose a particular

[102] As mentioned in Case No 38/31 CRSD Decision No 798/L/D1/2010 of 1431 H; Case No 11/30 CRSD Decision No 664/L/D1/2009 of 1431 H.; Case No 63/30 CRSD Decision No 663/L/D1/2009 of 1430 H; Case No 91/30 CRSD Decision No 665/L/D1/2009 of 1431 H.
[103] See: CML, art49.
[104] Narrated by Al-Bukhari (Hadīth number 1), (n 20); Muslim, (Hadīth number 1599), (n 27).
[105] Yaqub ibn Abd al-Wahhab Ba Husayn, *Qaidat al-umur bi-maqasidiha: Dirasah nazariyah wa-tasiliyah, Arabic edition* (Maktabat al-Rushd 1999).
[106] ME Badar, 'Islamic Law (Sharia) and the Jurisdiction of the International Criminal Court' (2011) 24(2) Leiden Journal of International Law, 411–33.
[107] M Abu-Zahra, *Al-Jarima Wal-Uquba lIslam* (Crime and Punishment in Islam) (Dar Alfekir 1998) 396. As cited in Badar (n 106).

course of action; and (3) knowledge that the said act was illegal.[108] Thus Islamic law attaches great importance to intent. For any offence of Market Abuse to be proven under Islamic law intent must be proven this can be done by showing that the three conditions mentioned above were fulfilled.[109] However, intention does not need to be proven with regard to compensation. Under Islamic law, individuals can be made to pay compensation to any injured party, even if it cannot be proven that they intended to cause harm.

6.9 Defences

By now it must be clear that what does or does not constitute market manipulation or insider trading can be murky territory, as such it can be troublesome for both investors and regulators to realize when it is they are in violation of the law.

Under section 119 of the Financial Services and Markets Act 2000 the Financial Conduct Authority is to clarify in the 'Code of Conduct' behaviour that does not amount to market abuse (market manipulation and insider trading), and section 122 categorizes any behaviour such classified as not amounting to market abuse.[110] The Code of Conduct (MAR 1) lists a number of behaviours which do not constitute Market Abuse (Market Manipulation and Insider Trading).[111] These behaviours include for inside trading: a person forming the intention to trade in securities and then carrying them out (1.3.6);[112] the dutiful carrying out of orders on behalf of another (1.3.12);[113] behaviour based on inside information related to another company in context of a public takeover or merger etc (1.3.17);[114] and for improper disclosure: disclosing information to a Government Department, the Bank of England or any other regulatory body (1.4.3).[115] Furthermore the Code of Conduct lists a number of statutory exceptions to market abuse in MAR 1.10,[116] most prominent of which is that any behaviour aimed towards stabilization or buy back which falls within the scope of articles 3–6 of the Buy-Back and Stabilization

[108] ibid.
[109] Ali Alkhateeb, *Auqobt Aljarimah Fi Alshariah Alislamih* (Dar Alsalam 2009).
[110] Financial Services and Markets Act 2000, s119 and 122.
[111] MAR 1.
[112] MAR (1.3.6).
[113] MAR (1.3.12).
[114] MAR (1.3.17).
[115] MAR (1.4. 3).
[116] MAR 1.10.

Regulation would not constitute market abuse.[117] The Code of Conduct by giving instances/examples of what does and does not constitute market abuse sheds light upon and makes it easier for both traders and regulators to navigate the said murky waters.

While US law, in the form of the Securities and Exchange Act 1934, mentions certain acts that are considered manipulative etc,[118] it fails to give any examples of conduct that is construed as not manipulative. Neither the Securities and Exchange Act nor rule 10b-5 expressly mention any defences to market manipulation or insider trading that might be claimed by traders (unlike the Code of Conduct). However rule 10b5-1(c) enacted under section 10(b) of the Securities and Exchange Act 1934 lists a number of 'affirmative defences' to insider trading. These defences apply if the accused entered into the contract for sale or purchase of the related securities before becoming aware of the 'material non-public information'.[119]

The primary Saudi Arabian law on market manipulation and insider trading in the form of the Capital Market Law and the Market Conduct Regulations are both silent as to any defences. But since the law is still under development it is likely that the Saudi Committee for Resolution of Security Disputes would entertain defences if plead despite them not being mentioned statutorily.[120]

6.10 Regulatory Authorities and their Powers

One of the key ingredients for a healthy securities market where investor confidence is high and natural market principles determine outcomes, is a strong regulatory body equipped with an arsenal of powers to maximize its effectively. For a financial regulatory body to be effective its powers must include, *inter alia,* investigative powers, punitive powers and powers to provide the victims with compensation. The primary regulatory bodies in the UK, US and Saudi Arabia are the Financial Conduct Authority, the Securities and Exchange Commission and the Capital Market Authority, respectively. The Financial Conduct Authority was established by the Financial Services Act 2012 and replaced the Financial Services Authority. Any

[117] MAR 3 and 6.
[118] Securities and Exchange Act 1934.
[119] Securities and Exchange Act 1934, art10(b).
[120] CML, art 25.

regulatory body is incomplete if it lacks the power to call for, gather and process information. The Financial Conduct Authority has the power to call for information from any person,[121] to ask skilled persons for reports,[122] and to appoint 'investigators' to investigate potential violations etc on its behalf.[123]

The Financial Services and Markets Act 2000 gives the Financial Conduct Authority a wide range of punitive and rule making powers most prominent of which are that it can pass a 'Prohibition Order' prohibiting an individual the Authority deems not to be 'fit and proper' from participating in a regulated activity,[124] where there is a violation of listing rules the Authority may impose a penalty as to an amount it considers appropriate,[125] and it has the power to make rules on various subjects.[126] The authority is empowered with general powers to take the disciplinary measures of publishing a statement publicly censuring[127] the violator as well as imposing the penalty[128] of a sum it thinks reasonable. The Authority is especially empowered by section 123 of the Financial Services and Markets Act 2000 in cases of market abuse to issue the offender with a penalty for a sum it deems reasonable or alternatively issue a public statement as to his guilt.[129]

Whenever market manipulation or insider trading takes place, a select few profit at the expense of others, usually a much larger number. Penalizing the individuals responsible for market manipulation or insider trading is not enough, an essential part of resolving the ill is compensating the wronged individuals. The standard route typically adopted has been a private action of civil suit for damages by the aggrieved individual(s) against those responsible for market manipulation or insider trading. Under section 150 of the Financial Services and Markets Act 2000 wherever an authorized person is in contravention of a rule, any private person who has suffered a loss as a result of the said contravention may bring a private suit in exercise of their legal right.[130] This process usually resulted in their being multifarious litigation as

[121] FSMA 2000, s 165.
[122] ibid s 166.
[123] ibid s 167.
[124] ibid s 56.
[125] ibid s 91.
[126] ibid Pt X.
[127] ibid s 205.
[128] ibid s 206.
[129] Financial Services and Markets Act 2000, s123.
[130] ibid s150.

first the Financial Conduct Authority would start proceedings, but since the individuals who had suffered losses would not be compensated in the regulator's action they would have to initiate separate proceedings for recovery. This promotes multiplicity of litigation, a higher burden on the court system, a wastage of time and gross overall inefficiency. A much more efficient system would be if the court or the regulatory authority were able to provide restitution to those who had suffered losses due to market manipulation or insider trading. This is achieved by section 382 of the Financial Services and Markets Act 2000 (section 383 where market abuse has taken place), which states that the court can make a restitution order on application of the Authority or the Secretary of State for any profit made by the abusive act, for the money to be paid to the Authority so that it may return it to those to whom it is attributable.[131] Section 384 even goes one step further empowering the Authority in instances of 'market abuse' to make restitution on its own accord, taking the profits of 'market abuse' from the offenders and returning them to those who have suffered losses.[132] The approach of section 384 is by far the most efficient; not only does it significantly reduce the need for litigation, it reduces costs, the burden on the court system as well as the time taken for those who had suffered losses to be compensated.

Similarly to the Financial Conduct Authority, the Securities and Exchange Commission has the power to investigate, and can appoint investigators to gather evidence, issue subpoenas, etc.[133] Under the Securities and Exchange Act 1934 where the Securities and Exchange Commission thinks an individual or a group of individuals has violated any of the respected provisions it can initiate a (civil) action in which the court can make an order as to penalties.[134] The Securities and Exchange Commission is similar to the Financial Conduct Authority in that in certain instances if it deems fit it can itself also impose a penalty on those in breach.[135] Similarly to the Financial Conduct Authority the Securities and Exchange Commission can give an injunction in the form of a 'Cease and Desist' order prohibiting the suspected individual from engaging in the suspected activity.[136] The 'Cease and Desist' order

[131] ibid s383.
[132] ibid s384.
[133] Securities and Exchange Act 1934, s 21.
[134] ibid s 21(3).
[135] ibid s 21B.
[136] ibid s 21C.

can take various forms – it can be temporary, it can prohibit suspected persons from acting as officers or directors of companies, and most importantly akin to the Financial Conduct Authority's power of restitution the Securities and Exchange Commission has the power of 'Disgorgement'. The difference between Financial Conduct Authority's 'restitution' and the Securities and Exchange Commission's 'disgorgement' is primarily semantic; both in essence mean confiscating ill-gotten gains from those in violation of their respective regulatory laws, and using these ill-gotten gains to compensate those who have suffered as a result.

The Capital Market Authority is the primary securities regulatory body in Saudi Arabia and was established under article 4 of the Capital Market Law.[137] The Capital Market Authority has a number of responsibilities including issuing rules, regulations etc. and applying the law (article 5).[138] The Capital Market Authority regulates the issuance of securities, protects citizens and investors from unfair market practices as well as regulating the Saudi Stock Exchange. Article 6 of the Capital Market Law lists a number of the Capital Market Authority's powers, including the powers to approve, suspend or cancel the listing of any security; and the prohibiting of any security.[139] Where any individual is in violation of the law (the Capital Market Law, Market Conduct Regulations or any other rules or regulations issued by the Capital Market Authority), article 59 of the Capital Market Law empowers the Capital Market Authority to bring a legal action against the accused in front of the Committee, which in turn may impose an appropriate sanction.[140] The sanctions at the Committee's disposal are listed in article 59 the most prominent of them being obliging the violator to stop the illegal behaviour (or to take steps to avert the results of the violation), suspending trading in the security (similar to an injunction), imposing a fine and barring the violator from working as a broker, portfolio manager or investment advisor for the time period it feels appropriate. Additionally the Capital Market Authority under article 59(a)(4) can ask the Committee to impose a sanction indemnifying the individuals who have suffered losses as a result of the violation or obliging the violator to pay his ill-gotten gains to

[137] CML, art4.
[138] CML, art5.
[139] CML, art6.
[140] CML, art 59.

the Committee.[141] This last sanction, 'indemnification' in effect is similar to the restitution ability of the Financial Conduct Authority and the disgorgement power of the Securities and Exchange Commission.

Despite operating in different financial markets the powers of the Securities and Exchange Commission and the Financial Conduct Authority are very similar, this is perhaps a result of decades of incorporation of trial and error in search of optimum efficiency. Both have necessary investigative powers, punitive powers and most importantly the power to compensate the victims of market manipulation or insider trading saving them from undergoing onerous litigation proceedings. In contrast to both of them is the Saudi Capital Market Authority. Securities and finance markets are rapid ever-changing worlds where millions of dollars' worth of securities are traded in seconds, as such regulatory authorities need to have teeth, powers they can themselves exercise, sanctions they can themselves impose. While article 59 lists a decent set of sanctions it is pertinent to note that none of them are applied at the discretion of the Capital Market Authority, whose only power is bringing a legal action in front of the Committee asking them to impose the sanction.[142] This causes delay; in our discussion of the selected cases in Chapter 2 we have already seen that in Saudi Arabia most individual violators are only caught once they have committed numerous violations.[143] If the Capital Market Authority is ever to achieve the same regulatory dominance as its US and UK counterparts it must be given more powers (especially to enforce interim and final sanctions).

During Islamic law times (sixth century Arabia), most matters of state including state decisions and regulatory matters (at the time primarily in trading and the commodities market), were done by the executive decision of the Caliph or his appointees.[144] The Caliph had a plethora of powers, ranging from investigative to punitive, and he took executive decisions without any further reference to the *Qadi* (the judicial system).[145] Applying the same principles and structure to a regulatory system created under Islamic law today one can see that such a regulatory body

[141] CML, art 59(a)4.
[142] CML, art 59.
[143] See Chapter 2.
[144] Abdulah Ibn Khunyn, '*Almahkamah Fi Alqda Alislami*' (2003) 18 Al-Adl Journal – Ministry of Justice 5–7.
[145] ibid.

would have vast powers from the initial investigation of the abuse to the final verdict.

6.11 Criminal Regime

As a general rule the threshold to win a civil case is the ‘balance of probabilities’ (also known in the US as a ‘preponderance of evidence’) and a criminal case ‘beyond reasonable doubt’. It requires a substantially higher standard of proof to prove a criminal case than it takes to prove a civil one. This is the reason that many cases lose criminal trials but win civil ones. In the UK under the old regime of the Financial Services Act 1986 the state’s emphasis in securities regulation litigation was on criminal prosecutions. Since criminal trials have a higher standard of proof they are harder to win, and hence a number of prosecutions did not result in success. Even the current regime in the UK, which contains offences relating to the supply of misleading information and the creation of misleading information as to the market has not seen any success. In the US the emphasis has primarily also been on bringing civil proceedings by the Securities and Exchange Commission. Analysis of the cases in Chapter 2 shows that even in Saudi Arabia the emphasis is on bringing civil proceedings. While civil proceedings in cases of market proceedings have many benefits, effective regulation demands that in instances of extreme and manifest abuse, criminal proceedings be brought against those in violation. In all the jurisdictions discussed above, a criminal regime runs concurrent to the civil one.

In the UK under sections 89, 90 and 91 of the Financial Services Act 2012 the Financial Conduct Authority can bring criminal proceedings for market manipulation.[146] The Authority is also authorized under Section 402 of the Financial Services Markets Act 2000 to bring criminal proceedings under Part V of the Criminal Justice Act 1993 for ‘insider dealing’.[147] While section 118 has been drafted giving the courts and the Authority wide discretion of interpretation, section 89, 90 and 91 (market manipulation) of the Financial Services Act 2012 and section 52 (insider trading) of the Criminal Justice Act 1993 have been linguistically constructed to provide greater detail than their civil counterparts. This is probably because the drafters wanted more stringent criteria to be passed before a criminal

[146] Financial Services Act 2012, s89,90 & 91.
[147] ibid s402.

conviction could be secured. Section 118 Financial Services Act 2000 also covers the offence of insider dealing.[148] It defines this as behaviour occurring on the basis of information not publicly available which a reasonable person would consider as falling below the standard expected of a reasonable person operating in the market. Section 52 on the other hand is more specific and provides greater detail, categorically stating that an insider will not only be guilty if he uses the 'inside information' himself but also if he discloses it to another, or if he encourages anyone else to deal in the related securities.[149] Section 53 of the Criminal Justice Act 1993 provides defences for all three of the insider dealing offences mentioned in section 52 above.[150] The rest of Part V gives detailed definitions of a number of terms used in sections 52 and 53, most prominent of which are dealing (section 55), insiders (section 57) and insider information (section 56).[151] It is also pertinent to mention that while the Financial Conduct Authority is the primary regulator of securities in the UK, section 1 of the Criminal Justice Act 1987 created the Serious Fraud Office which investigates and if appropriate prosecutes those who commit serious and complex fraud, bribery and corruption cases within their given mandate.[152]

While the UK has a primary securities regulatory body (the Financial Conduct Authority) which is responsible for bringing both civil and criminal proceedings, in the US the Securities and Exchange Commission only brings civil proceedings and any cases it feels warrant criminal prosecution it refers to the Department of Justice. Furthermore, unlike the UK which has separate laws or provisions for civil and criminal offences, the applicable US law for both regimes is the same. The same securities statutes that provide laws for civil offences have clauses that enable them to be used for criminal prosecutions. Under dual regimes of this sort the same law or offence is used for both civil and criminal cases; for example, in the OJ Simpson case the state first brought criminal proceedings for murder, but once the case was lost another proceeding in civil law was brought for wrongful death, this second proceeding proving successful. The difference however would be the requirements and standard to be fulfilled in order to satisfy both regimes. In the US the primary law on market manipulation and insider trading is contained in the Securities and

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[148] ibid s118.
[149] Criminal Justice Act 1993, s53.
[150] ibid.
[151] ibid s52,53,56 and 57.
[152] The Official website of the Serious Fraud Office <http://www.sfo.gov.uk/> accessed 7 April 2015.

Exchange Act 1934 which is used for civil proceedings. However under section 32(a) of the Securities and Exchange Act 1934 any individual who violates any provision:[153]

> shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $25,000,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

Thus section 32(a) gives the Securities and Exchange Act 1934 full applicability in criminal cases as well as specifying the test to be used and the penalties to be given.[154] This again is in contrast to UK law, which codifies civil and criminal laws separately. Additionally while in the UK the Financial Conduct Authority can conduct both criminal and civil proceedings, criminal proceedings in the US are not handled by the Securities and Exchange Commission whose authority is limited to matters within the civil regime.

In Saudi Arabia securities law is still in its early stages with the regulator, the Capital Market Authority, still navigating its way. Like the US but unlike the UK, Saudi Arabian law does not host alternative laws for civil and criminal regimes (as far as market manipulation and insider trading are concerned). The primary laws governing market manipulation and insider trading are contained in the Capital Market Law and Market Conduct Regulations. It appears from the cases analysed in Chapter 2 however that the Capital Market Authority's focus is on civil proceedings.[155] Pursuant to the High Order No (4690) dated 6/2/1435 the Capital Market Authority is to start referring criminal proceedings/offences under articles 31[156] (licensing requirement for brokerage business), 49[157] (Market Manipulation) and 50[158] (Insider Trading) to the Bureau of Investigation and Public Prosecutions.[159] Thus the future of the Capital Market Authority appears to be similar to that of the Securities and Exchange Commission in the US; the Capital Market Authority would

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153 Securities and Exchange Act 1934, s32(a).
154 ibid.
155 See Chapter 2.
156 CML, art 31.
157 CML, art 49.
158 CML, art 50.
159 Official website of the Capital Market Authority <http://www.cma.org.sa/En/News/Pages/CMA_N_1589.aspx> accessed 27 November 2015.

handle civil proceedings in instances of market manipulation and insider trading whereas the Bureau of Investigation and Public Prosecution, like the US Department of Justice, would handle criminal proceedings.

In sixth-century Arabia, state enforcement of crime was primarily done by the executive. In Islamic law there are three primary classifications of offences *Hadd*, *Tazir* and *Qisas*.[160] *Hadd* offences are the offences that have a fixed penalty stated in the Qur'an, these are usually more serious offences like theft, consuming intoxicants, etc.[161] *Tazir* offences are punishable offences but the Holy Qur'an does not expressly provide these punishment, this puts these punishments at the discretion of the head of state.[162] *Qisas* offences are offences against the person such as murder, manslaughter and battery.[163] Applying these concepts one can see that Islamic law too maintains a dualistic regime with civil offences being brought privately by individuals in the form of claims in front of the *Qadi* and criminal offences being punished by the Caliph (or in his name by those designated). Market manipulation and insider trading are offences involving dishonesty, in which property (money) belonging to another is fraudulently appropriated. While the act sounds similar to theft, it is far more sophisticated, lacking any of the physical appropriation elements. It is more likely that under Islamic law the offences of Market abuse would be categorized as *Tazir*, which gives the Caliph (or head of state) the discretion to decide the penalty.

6.12 Conclusion

Each of legal regimes discussed in this chapter recognize the threat Market Manipulation and Insider Trading pose. As such, each regime has attempted to develop its own tools, in the form of laws and regulatory practices to combat it. Although some differences are seen between the three legal regimes (UK, USA and Saudi Arabia), they have all attempted to use modern knowledge of market abuse to formulate their laws. So while their laws may differ in form and procedure, they are similar in substance. The US and UK, with the older legal structures, have

[160] Abu-Zahra (n107).
[161] ibid.
[162] ibid.
[163] ibid.

continually developed their securities laws over decades, while Saudi Arabian law despite its recent start closely following in their footsteps. In addition, the distinction between Islamic law and other legal systems lies in two things:

First: Islamic law encourage people to learn trading and its' methods, so then they can be aware of what they are doing, and no doubt this will reduce the number of violations in trading. Second: Islamic law focuses on trading values and requests all dealers to be honest and promote honestly, and warns against lying and cheating, marking them as sins. And this issue in particular does not exist in other law systems, and of course this is a lacuna that the manipulators use to create problems. The next chapter will be a concluding chapter, created on my arguments related to the comparison study, critical thinking and further based on recommendations.

CHAPTER 7: CONCLUSION AND RECOMMENDATIONS

This final chapter summarizes and brings together the main points covered in the study. It further provides recommendations for reforming and improving corporate governance in Saudi Arabia.

7.1 Conclusion

The main purpose of this study was to propose reform measures from a legal perspective, which would serve to counter manipulative practices on the Saudi stock market. The Capital Market Law, now well established in Saudi Arabia, gradually replaced the largely cultural and religious norms under Islamic law, which largely preceded it. According to Professor Otto Kahn-Freund:

> the point that we cannot take for granted that rules or institutions are transplantable. The criteria answering the question whether or how far they are, have changed since Montesquieu's day, but any attempt to use a pattern of law outside the environment of its origin continues to entail the risk of rejection. The consciousness of this risk will not, I hope, deter legislators in this or any other country from using the comparative method. All I have wanted to suggest is that its use requires a knowledge not only of the foreign law, but also of its social, and above all its political, context. The use of comparative law for practical purposes becomes an abuse only if it is informed by a legalistic spirit, which ignores this context of the law.[1]

In Saudi Arabia, the Shariah Courts also function in a way that enables them to address modern issues, as outlined in Chapter 2 Islamic law encompasses various schools of thought that address the issues under examination in a number of different ways. The effect of Western civilization – its philosophy, values and lifestyles – is global in its extent and influence: global in that it touches all aspects of life, and the Muslim world is no different in this regard.

The effect of Western civilization on Muslims does not stop at lifestyle, food, buildings, transport and other material appearances, but penetrates to the degree that it impacts personal relationships and wider societal bonds; but its scope reaches beyond the personal domain, to the extent that financial transactions, practices and

[1] O. Kahn-Freund, 'On Uses and Misuses of Comparative Law' (1974) 37 (1) The Modern Law Review 1, 27.

regulatory codes also fall under its influence. Bearing this in mind, it could reasonably be argued that at present the majority of financial transactions are historically derived from Western laws rather than Islamic jurisprudence.

This does not mean that these transactions are not compatible with Islamic precepts, and that there is a need to impose laws that are fundamentally Islamic in conception, character and form. Rather, even if it were desirable, requisite constraints would render any such efforts largely moot. Accordingly, what is required is a jurisprudential examination of transactions, with a view to determining their compatibility with Islamic law; consequent modifications and amendments can then be undertaken where necessary in order to ensure appropriate fit.

However obtaining and applying what is “required and possible” is not always easy, it is a route beset by obstacles and difficulties; so Islamic jurisprudence should consider two issues: first- the definition of the term and its import under the law; and second - not paying attention to the characteristics of the transaction its’ nature, origin and development.

The research set out to provide a general understanding of current regulations in relation to market manipulation in Saudi Arabia. The thesis accordingly encompassed seven chapters.

Chapter 1 provides an introduction outlining the research questions, methodology, problem, objectives and structure.

Chapter 2, which follows on from this introduction, has embarked on market manipulation in Saudi Arabia and consist of five sections. The first section deals with the historical development of the CML. The second section considers the argument regarding the secular approach of the CML. The third section examines the CML. The Saudi Arabian stock market in its current form is still nascent and developing. The Saudi authorities, realizing the necessity for safeguarding the stock market and all stakeholders have promulgated a series of laws including the Capital Market Law, the MCR and the registering and licensing rules. However, as is apparent from the cases discussed above, on multiple occasions the accused were indicted after numerous offences had already been committed. If the stock market is to be adequately protected, the Saudi Authorities need to improve enforcement of the promulgated laws, by better monitoring of the stock markets.

Chapter 3 provides background information about Islamic law of market manipulation. This chapter is in six sections. In the first section, there is a discussion and description of Islam as a religion and its legal sources. Here, in the context of Islamic law, the Qur'an and the Sunnah are examined as primary Islamic legislative sources, as well as the *Ijma* and the *Qiyas* as secondary Islamic law sources. The second section analyses Islamic objectives. Section three studies whether or not principles of market manipulation supplemented in Islamic law attain their purpose. Finally, a summary is provided. Islamic financial law is rich in providing the solutions and concepts necessary to avoid the disaster of recession, as well as in dealing with the effects of economic decline. Yet the transfer of these concepts to the principles of economic policy requires the combined efforts of Islamic jurists and financial professionals in order to develop standards in synchronization with the complexities of contemporary society.

Chapter 4 which elaborates and underpinned the concept of market manipulation in the US and comprise with three sections. The first section deals with the historical basis, showing how manipulative practices have evolved and how these have affected the markets today. The second section examines the definition of manipulation under US law. The third section deals with legal developments in US market manipulation law. In this chapter, as mentioned, in the US it has been established that securities laws seek to penalize or regulate misleading statements, market manipulation and other relativities as they are aware of the damage that can be caused in relation to the orderly functioning of the wider securities market.

Chapter 5 primarily covers market manipulation in the UK in a more historic or past setting. It introduces and covers the various legal regimes that apply to market abuse, including prominent EU past, present and future laws which either do or will in the future have a significant impact on the market abuse law of the UK. The civil market abuse law in the UK is contained in section 118 of the FSMA 2000, this was amended when the MAD came into effect, now the law might again need to be amended when the MAR takes effect in 2016. In the global village, market abuse is being fought collectively as well as individually. Collectively, the EU's measures in the form of the MAD and the MAR (as well as various other laws) aim to help all the regulators in EU markets work together in unison.

Chapter 6 focuses on comparing the laws of market manipulation of Saudi Arabia, the US, UK and under Islamic law. All the legal regimes discussed in this chapter recognize the threat posed by market manipulation and insider trading. As such, each regime has attempted to develop its own tools, in the form of laws and regulatory practices to combat it. Although some differences are seen between the three legal regimes (Saudi Arabia, US and UK) they have all attempted to use modern knowledge of market abuse to formulate their laws.

Chapter 7 offers a conclusion and makes recommendations with the aim of reforming market manipulation practices in Saudi Arabia. Suggestions for future research and identification of the key contributions of the study are included in this chapter.

7.2 Recommendations for the Reform and Improvement of Saudi Market Manipulation

Some recommendations and suggestions concerning market manipulation issues in Saudi Arabia emerged from the research. These are outlined below.

The nature of Saudi Arabia's financial market leaves it susceptible to manipulation, more so than the financial markets of other developed countries. Causative factors are many: a lack of listed companies, a lack of funds, inaction in dealing with investor manipulation, and punishments which are not dissuasive enough to act as a sufficient deterrent.

As the research has shown, the integrity of the financial markets and an adequately enforced regulatory code are necessary conditions, which must be met if the market is to maintain any measure of credibility and prosper over the longer term.

Studies have shown that manipulation in finance markets cannot be avoided entirely. Even members of the securities industry may be guilty of oversight and poor practice. Any new system engaged to counter this must deal with all possible cases of manipulation and must be fully supported by both the executive and judicial branches; strict enforcement of the regulations is a prerequisite. At present, there is an unacceptable dearth of information with respect to the operation of the regulatory regime, and this has, as a consequence, hampered the Saudi authorities' efforts to both enforce the code and adequately highlight for the wider public the advantages such a regime confers in practice. These deficiencies have likely dampened and curtailed investor interest both within Saudi itself and at a greater remove.

The author after having a thread bar discussion on the primary issue of financial market and its manipulation has come up to a decisive conclusion. Which is in order to protect the right of the investor and bring a fair balance between him and capital market following recommendations are imminent.

- In order to reduce the financial market manipulation it is evident that a licencing system should be introduced to streamline the market manipulation mechanism. All dealers must have to pass the rigorous criteria to get the licence and must be aware with the concept of 'behaviour of marketing' and its effects. Furthermore, without the knowledge of the financial market methods and risk management no dealer will be allowed to carry on business. It is further recommended that all the dealers must be well aware of several types of market abuse and method of violations.
- The concept of Market manipulation is very broad and covers a number of issues; in this regard a recommendation has made to constitute a supervisory committee. This committee should have an independent entity and not accountable to capital market authority anyway. It is to counter the market manipulations, effectively and if anyone found guilty the committee can take the cognizance of the case, and punish the accused without taking further permission from capital market authorities. However, if an accused disagree with the decision, an option he may be able to invoke the cognizance of the court. In this regard the courts should have the excess to the experts relating to market manipulations, in-order to get the advisory opinion and further recommendations.

- There should be a body wise enough and knowledgeable like a Muslim Judicial Council to seek advice and if required get recommendations on the issues related to the market manipulations time to time. Like a British Judicial system, it is recommended that the Judges should be well aware, well acquaint and well informed with the latest knowledge relating to the financial market and its manipulations. Seminars, workshops and special courses should be designed for them to get aware from the latest issues.
- The Committee needs to evince a greater degree of transparency: it should publish records of how many unique investigations were initiated each year, and how many inquiries were carried over from previous years.
- The percentage of cases where the Committee's decision is in agreement with the findings of the CMA should be disclosed, as should those figures where the Committee's decision differs from that of the CMA. It is important that the percentage of cases where the Committee quashed penalties issued by the CMA be divulged.
- It is recommended that a committee is established that consists of scholars of *usul-al-fiqh*, legal specialists and lawyers.
- With the support of the financial markets, the Capital Market Authority could hold an awareness campaign targeted at all parties in the financial marketplace.
- Finally, Saudi Arabia should adopt those legal models implemented by other states in dealing with and regulating financial markets.

7.3 Future Research Avenues

Although some few studies have considered the provisions and practices implemented in Saudi Arabia aimed at countering market abuses, as far as this researcher is aware, this study is among the first to examine market manipulation provisions and practices from a legal perspective. There is, therefore, a need not only for further research into these provisions from differing legal perspectives, but also for further general studies into market abuse practices in Saudi, given the current paucity of research evident in the literature.

7.4 Contribution to Knowledge

The principal contribution of this study is its work in addressing the current gaps in the literature on contemporary market abuse practices within Saudi Arabia from a legal perspective. Secondly, this study proposes a number of reforms in relation to current market manipulation practices in the Saudi market in order to bring it into alignment with international codes of practice and standards. Thirdly, this study has introduced an Islamic perspective into the discussion on market abuse in order that any additional insights it may provide would assist in the formulation of recommendations for countering market abuse practices. Finally, the study has attempted to develop and set out a suitable framework for the curtailment of market abuses in Saudi Arabia.

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APPENDICES 1

Chapter Eight: Manipulation and Insider Trading

Article Forty Nine

(a) 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 for the purpose of

creating that impression or thereby inducing third parties to buy, sell or subscribe for such Security or to refrain from

doing so or to induce them to exercise, or refrain from exercising, any rights conferred by such Security.

(b) The Authority shall set out rules determining the acts and practices which shall constitute violations of paragraph (a) of

this Article. These rules shall specify the acts and practices excluded from the application of the provisions of paragraph

(a) of this Article. The powers of the Authority provided for in this paragraph shall include the power to set forth the

rules, define the circumstances and procedures aiming at stabilizing the prices of Securities offered to the public, and the

manner in which and the period during which these actions must be taken.

(c) The following acts and practices shall be among those which shall be considered types of manipulation that are prohibited

by paragraph (a) of this Article:

1) To perform any act or practice aiming at creating a false or misleading impression of an existing active trading in a

Security as may be contrary to the reality. These acts and practices shall include, but not be limited to the following:

(a) Undertaking transactions in Securities which 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 substantially 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, for the purpose of inducing 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 a

Security traded on the Exchange for the purpose of pegging or stabilizing 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.

Article Fifty

(a) Any person who obtains, through family, business or contractual relationship, inside information (hereinafter an "insider") is prohibited from directly or indirectly trading in the Security related to such information, or to disclose such information

to another person with the expectation that such person will trade in such Security.

Insider information means information obtained by the insider and which is not available to the general public, has not

been disclosed, and such information is of the type that a normal person would realize that in view of the nature and

content of this information, its release and availability would have a material effect on the price or value of a Security

related to such information, and the insider knows that such information is not generally available and that, if it were

available, it would have a material effect on the price or value of such Security.

(b) No person may purchase or sell a Security based on information obtained from an insider while knowing that such

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

(c) The Authority has the power to establish the rules for specifying and defining the terms provided for under paragraphs

(a) and (b) of this Article, and such acts or practices which the Authority deems appropriate to exempt them from their

application, as may be required for the safety of the market and the protection of investors.

Chapter Ten: Sanctions and Penalties for Violations

Article Fifty Five

(a) In case a prospectus, when approved by the Authority, contained incorrect statements of material matters or omitted

material facts required to be stated in the prospectus, the person purchasing the Security that was the subject of such prospectus shall be entitled to compensation for the damages incurred by him as a result thereof. A statement or

omission shall be considered material for the purposes of this paragraph if it is proven to the Committee that had the

investor been aware of the truth when making such purchase it would have affected the purchase price.

(b) The following persons shall be liable under paragraph (a) of this Article:

1) The party issuing the Security. The issuer shall be liable irrespective of whether it had acted reasonably, or it was not

aware of the incorrect statements in connection with material matters, or of the omission of material facts that should

have been disclosed in the prospectus.

2) The senior officers of the issuing party of the Security in accordance with the definition provided in the rules issued

by the Authority. Such liability could be relieved according to paragraph (c.1 and 2) of this Article.

3) The members of the board of directors of the issuing party, or persons performing similar functions, as of the date on

which the prospectus was approved by the Authority. Such liability could be relieved in accordance with paragraph

(c.1 and 2) of this Article.

4) The underwriters who have undertaken to offer on behalf of the issuer the Security for sale to the public, provided

that 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).

5) 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; 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, unless he proves that he was convinced after

conducting reasonable investigations and on the basis of reasonable grounds, that that part of the prospectus is not in

violation of paragraph (a) of this Article.

(c) Any of the persons mentioned in paragraph (b.2, 3 and 4) of this Article shall be liable as provided for in the provisions

of paragraph (a) of this Article unless it is proven that:

1) As to any part of the prospectus not certified by the person described in paragraph (b.5) of this Article that, after

reasonable investigation, and on the basis of reasonable grounds, he was convinced that such part of the prospectus

was not in violation of paragraph (a) of this Article;

2) As to any part of the prospectus purporting to have been made based on the statement of a person set forth in

paragraph (b.5) of this Article, and the person invoking the defense is identified in paragraphs (b.2, 3, 4) of this Article,

he had no reasonable ground at that time to believe that such part of the prospectus contained what could be

deemed a violation of paragraph (a) of this Article.

(d) In determining that investigation shall be deemed reasonable or what shall constitute reasonable ground for belief for the

purposes of paragraph (c) of this Article, the standard of reasonableness for the purpose of this Article shall be that of the prudent man in the management of his property.

(e) Damages may be obtained through a claim brought on the basis of paragraph (a) of this Article, which 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 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. The defendants are individually and jointly and severally liable for damages for which they are responsible under this Article. The amount of indemnification 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 believes is equitable and does not harm the interest of investors or otherwise contravene the spirit of this Law.

Article Fifty Six

(a) 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. 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 should prove:

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

2) That either 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.

3) 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.

(b) 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 Article 55 of this Law.

(c) 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 paragraph (a) of Article 55 of this Law.

Article Fifty Seven

(a) Any person who violates Article 49 of this Law or any of the regulations or the rules issued by the Authority pursuant to

the 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 a 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 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 indemnity and contribution among

the persons responsible shall be measured 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.

APPENDICES 2

Capital Market Authority

Market Conduct Regulations

Issued by the Board of Capital Market Authority Pursuant to Resolution No. 1/212/2006 dated 21/10/1427AH (corresponding to 12/11/2006) based on the Capital Market Law issued by Royal Decree No. M/30 dated 2/6/1424AH

Amended by Resolution of the Board of the Capital Market Authority Number 1-10-2010 Dated 30/3/1431H corresponding to 16/3/2010G

English Translation of the Official Arabic Text Arabic is the official language of the Capital Market Authority

The current version of these Rules, as may be amended, can be found at on the CMA website: www.cma.org.sa

Contents

Part 1: Preliminary Provisions

Article 1: Definitions

(a) Any reference to the "Capital Market Law" in these Regulations shall mean the Capital Market Law issued by Royal Decree No. M/30 dated 2/6/1424H.

(b) Expressions and terms in these Regulations have the meaning which they bear in the

Capital Market Law and in the Glossary of defined terms used in the Regulations and Rules of the Capital Market Authority, unless the contrary intention appears.

Part 2: Prohibition of Market Manipulation

Article 2: Prohibition of Manipulative and Deceptive Acts or Practices

(a) It is prohibited for any person to engage in or participate in any manipulative or deceptive acts or practices in connection with an order or transaction in a security, if the person knows or has reasonable grounds to know the nature of the act or practice.

(b) It is prohibited for any person to, directly or indirectly, enter an order or execute a

trade in a security for the purpose of creating any of the following:

1) A false or misleading impression of trading activity or interest in the purchase or sale of the security; or

2) An artificial bid price, ask price or trade price for the security or any related security.

Article 3: Manipulative and Deceptive Acts or Practices

(a) The following actions shall be among those considered as manipulative or deceptive

acts or practices:

1) Making a fictitious trade; or

2) Effecting a trade in a security that involves no change in its beneficial ownership.

(b) The following acts shall be among those considered as manipulative or deceptive acts or practices when committed for the purpose of creating a false or misleading impression of trading activity in a security or interest in the purchase or sale of the security, or for the purpose of creating an artificial bid price, ask price or trade price for a security:

1) Entering an order or orders for the purchase of a security with the prior

knowledge that an order or orders of substantially the same size, time and price for the sale of that security, has been or will be entered;

2) Entering an order or orders for the sale of a security with the prior knowledge that an order or orders of substantially the same size, time and price for the purchase of that security, has been or will be entered;

3) Purchasing or making offers to purchase, a security at successively higher prices or in a pattern of successively higher prices;

4) Selling or making offers to sell a security at successively lower prices or in a pattern of successively lower prices; or

5) Entering an order or orders for the purchase or sale of a security in order to:

ƒ. Establish a predetermined sale price, ask price or bid price;

ƒ. Effect a high or low closing sale price, ask price or bid price;

ƒ. Maintain the sale price, ask price or bid price within a predetermined range; or

ƒ. Entering an order or a series of orders for a security that are not intended to be executed.

Part 3:Insider Trading

Article 4: Disclosure of Inside Information and Insider Trading Defined

(a) For purposes of the application of Article 50 of the Capital Market Law and the provisions of this Part:

1) A security related to inside information must be a traded security.

2) A security related to inside information shall mean any security whose price or value would be materially affected if the information was disclosed or made available to the general public.

3) A person shall be considered directly trading in a security in any of the following two situations:

ƒ. I f he executes a trade in the security for any account in which he has an interest; or

ƒ. If he makes a bid or offer on the Exchange for the security.

4) A person shall be considered indirectly trading in a security in any of the following

situations:

ƒ. If he executes a trade as agent for another person;

ƒ. If he arranges a trade to which a relative or person with whom he has a business or a contractual relationship is party; or

ƒ. If he arranges for his agent or any other person acting on his behalf or at his direction to trade in the relevant securities.

5) Trading shall constitute insider trading, if it is directly or indirectly effected in a security related to inside information.

(b) For greater certainty, insider means any of the following:

1) A director, a senior executive or an employee of the issuer of a security related to inside information;

2) A person who obtains inside information through a family relationship, including from any person related to the person who obtains the information;

3) A person who obtains inside information through a business relationship, including

obtaining the information:

ƒ. From the issuer of a security related to inside information;

ƒ. From any person who has a business relationship with the person who obtains the information; or

ƒ. From any person who is a business associate of the person who obtains the information;

4) A person who obtains inside information through a contractual relationship,

including obtaining the information:

ƒ. From the issuer of a security related to inside information; or

ƒ. From any person who has a contractual relationship with the person who obtains the information.

(c) For greater certainty, inside information means information that fulfils the following:

1) Information that relates to a security;

2) That has not been disclosed to the general public, and that is not otherwise available to the general public; and

3) That a normal person would realise that, in view of the nature and content of the information, disclosing it or making it available to the public would have a material effect on the price or value of the security.

Article 5: Prohibition of Disclosure of Inside Information

(a) An insider is prohibited from disclosing any inside information to any other person

when he knows or should have known that it is possible that such other person may trade in the security related to the inside information.

(b) A person who is not insider is prohibited from disclosing to any other person any inside information obtained from an insider, when he knows or should have known that it is possible that such other person to whom the disclosure has been made may trade in the security related to the inside information.

Article 6: Prohibition of Insider Trading

(a) An insider is prohibited from engaging in insider trading.

(b) A person who is not insider is prohibited from engaging in insider trading if he obtains the inside information from another person and he knows or should have known, that the information is inside information.

PUBLICATIONS:

Journal

Saad Aljloud, 'Ijtihād and Ikhtilāf : Re-interpreting Islamic Principles in Contemporary Times' (2014) 28 Arab Law Quarterly 85.

Saad Aljloud, 'Innovation in the Standard of Globalization Sukuk' (2014) 3 International Law Research 82

Conferences attended and presentations made

- Oral presentation, Regulation of Market Manipulation in Saudi Arabia (Brunel Law School UK, 29 April 2015).
- Oral presentation, Does Islamic jurisprudence provides a framework that regulates market manipulation? (Brunel Law School UK, 2 June 2014).
- Oral presentation, The Risk between Islamic Finance and Western Finance (Harvard Law School US, 24-25 April 2014).
- Oral presentation, To what extent is the Saudi capital market affected by market manipulation? (Newcastle Law School UK, 25 March 2014).
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