THE SUITABILITY OF US SECURITY LAWS AND REGULATIONS TO SERVE AS A MODEL LAW FOR EGYPTIAN FINANCIAL MARKETS

*Ahmed Y. Zohny**

INTRODUCTION

The Government of Egypt recognises the importance of investment for economic growth in the era of internationalisation of securities markets.[1] The Egyptian new Capital Markets Law 95 of 1992 ("Capital Markets Law"), was issued to respond to both domestic and international changes which have taken place since the October 1987 US stock market crash.[2] On the domestic front, following the dynamic economic growth beginning in 1975, Egypt, along with most other countries in the Middle East and North Africa, were hard hit by the oil price slump of the mid-1980s. Egypt's Economic Reform and Structural Adjustment Program ("ERSAP") started in 1990, and was formally ratified in May 1991, through agreements with the IMF. The World Bank (with the tacit approval of the USAID), has central components for the purpose of privatising public sector corporations and creating a climate conducive to attract both domestic and foreign investors to the Egyptian capital market.[3]

On the international front, the forces of globalisation were underway. The "one market" concept popularised by the Brady Commission seemed to be applicable not only to the interaction between the securities and futures markets, but also to the growing interdependence of the major securities exchanges of the world.[4] Klein and Coffee link this new tendency of globalisation of the securities markets to the October 1987 US stock market crash when record price declines occurred on the London, Tokyo, and Hong Kong exchanges, as well as in New York.[5] An era of a flawed international financial architecture was in place.[6] Secretary of the

* LL.M., Ph.D., Professor and Chairman of the Department of Business and Legal Studies at Strayer University, Alexandria, Virginia, USA.

[1] Richard W. Jennings, *et al.*, *Securities Regulation, Cases and Materials*, 1614 (8th ed. 1998).

[2] William A. Klein, John C. Coffee, Jr., *Business Organization and Finance, Legal and Economic Principles*, 403 (6th ed. 1996).

[3] Saad Eddin Ibrahim, *Egypt, Islam and Democracy, Twelve Critical Essays*, 133 (1996).

[4] See Klein, *supra* note 2, at 403.

[5] *Id.*

[6] Jerome I. Levinson, *The International Financial System: A Flawed Architecture*, 23-spg. Fletcher F., *World Aff.* I (1999).

Arab Law Quarterly, [2000] 5–47
© 2000 Kluwer Law International. Printed in the Netherlands.

HeinOnline -- 15 Arab L.Q. 5 2000

Treasury Robert Rubin has called for a strengthening of the architecture of the international financial system by providing better information through improved disclosure and transparency; by building strong national financial sectors; and creating mechanisms so that the private sector more fully bears the consequences of its credit and investment decisions.[7] That evolution, Levison argues, has resulted in a brutal competition among developing countries (including Egypt) to attract the same pool of Foreign Direct Investment (FDI).[8] To cope with the aforementioned complicated realities of the new international economic order, the Egyptian (Capital Markets Law) and Investment Law 8 of 1997 were passed by the Egyptian Parliament.[9] According to the aforementioned laws, foreign investors may own up to 100 per cent of establishments engaged in various activities within the scope of these laws.[10] Law 95 allows for the establishment of Egyptian and foreign securities companies conducting one or more of the following activities:

(1) Underwriting of subscriptions;
(2) Participation in the establishment of companies issuing securities;
(3) Venture capital;
(4) Clearing and settling of securities;
(5) Forming and managing securities portfolios and mutual funds; and
(6) Acting as brokerage firms.

In February 1996, the Egyptian Capital Market Authorities ("CMA") signed an agreement with the US Securities and Exchange Commission (SEC) for technical assistance and information exchange. The Egyptian authorities are also deepening and broadening ties with major international exchanges, including the New York Stock Exchange.[11] Large American clearing houses, such as Merrill Lynch and Legg Mason, are currently licensed to operate in the Egyptian capital market to serve both local and international investors.

This article argues on the suitability of US Security Laws and Regulations to serve as a model law for the newly regulated Egyptian financial market despite the differences in the origins of the two legal systems.

Furthermore, this article will provide some insights into the differences and similarities between US and Egyptian Securities Laws and Jurisprudence to guide US law firms who are representing US corporate clients in Egypt.

[7] *Id.*
[8] *Id.*
[9] The Capital Markets Law (1992) (Egypt).
[10] The Arab World Online, Egyptian Investment Climate Statement 7-8 (http://www.awo.net/business/invest/egy1.asp.).
[11] See The Arab World Online, *supra* note 10, at 12.

HeinOnline -- 15 Arab L.Q. 6 2000

THE ROLE AND IMPORTANCE OF THE CAPITAL MARKETS IN EGYPT'S TRANSITIONAL ECONOMY

The application of the socialist ideology and socialist measures introduced by former President Nasser of Egypt, resulted in the nationalisation of 95 per cent of foreign and Egyptian corporations.[12] The assets and ownership of these aforementioned corporations were transferred to the Egyptian Government, thus forming a large number of public sector corporations organised around industrial lines in the national economic and social development plan. As a result, the activities of the Egyptian stock exchange, *Bourseht-Al Awrak Al Maliah*, was drastically reduced to serve only nine corporations. This led to the domestic and foreign investors loss of confidence in the Egyptian economic system. Gradually, investors, entrepreneurs and venture capitalists left with their capital and expertise to other Arab countries, Europe and the USA. The concept of the stock exchange as an organised market for the purchase and sale of securities[13] and as a viable mechanism for making savings more readily and cheaply available to investors by creating liquidity and reducing transaction costs in any economy was completely forgotten.[14] One Egyptian generation did not hear or know enough about such a vital financial mechanism. Law and business schools of Egyptian universities did not offer courses in these topics (capital market) or *Bourse Des Valeurs* operations, from 1960 to 1974.

Egypt's economic problems

The World Bank's recent study on *Egypt in the global economy, strategic choices for savings, investments and long-term growth*, published in 1998, sent a central message to Egyptian policymakers, that "Egypt must save a lot more to maintain its capital resource base – that is, to replace the depletion of income generating assets resulting from the extraction of oil and natural gas. Further, Egypt can save a lot more through privatisation and reforms of public enterprises, through strengthening financial instruments and institutions for long-term saving and through efficient intermediation between savings and investments".[15] The World Bank's report is explicitly urging Egypt to strengthen its capital market and its stock exchanges and link them with international markets to stimulate foreign investors to invest in the public corporations securities.[16] How much in savings can come from privatisation and reform of Egyptian public enterprises? The World Bank answered this question by stating that "privatisation could increase savings, in part because the transfer of ownership to the private sector is associated with higher productivity".[17] Higher productivity generates more resources that can be

[12] See Ibrahim, *supra* note 3, at 137.
[13] Abdul Staar Bakry Hassan, *Bourseht-Al Awrak Al Maliah in Egypt*, 19 (1999).
[14] *Id.*
[15] See World Bank Middle East and North Africa Economic Studies, "Egypt in the Global Economy, Strategic Choices for Savings, Investments, and Long Term Growth", XIX (1998).
[16] *Id.*
[17] *Id.*

HeinOnline -- 15 Arab L.Q. 7 2000

consumed or saved.[18] Furthermore, privatisation may attract more savings from abroad, when multinational corporations invest in such growing industries as telecommunications, power and environmental industries.[19] Finally, the same report predicted that privatisation can contribute to savings by boosting capital market development, which has been shown to contribute positively to growth.[20] The World Bank's report was less affirmative on the direct impact of the stock markets in the level or rate of domestic saving. The study argues that:

> Many studies conclude that the impact of stock markets on the *level or rate* of domestic saving is ambiguous – savers may merely shift funds from one saving instrument (such as bank deposits) to securities. However, some studies have shown that there is a positive relationship between private saving as percent (*sic*) of GDP and financial sector development, which includes capital market development, although the channels through which this relationship is defined are numerous. For example, stock markets are seen to increase investment, thereby decreasing national income, thus increasing the level of or rate of domestic saving.
>
> But what is unambiguous is that the composition of saving is improved by the introduction of liquid capital markets. Savers purchase long term securities which offer higher expected returns and enable risk diversification. In the process, more financing opportunities become available to corporations to implement projects with long term pay-offs. Investors in long term projects need not relinquish their saving for long periods – liquid capital markets allow them to divest quickly and inexpensively.[21]

This article argues that in the case of Egypt, the development of capital markets both supports and is enhanced by the presence and development of contractual savings institutions.[22] The investments of private pension funds and insurance companies have been mainly in government securities and bank term deposits.[23] Developing an efficient capital market in Egypt is likely to allow for greater diversification and higher returns for these investments.[24] This, in turn, will lead to an improvement in the financial performance of contractual savings institutions which would result in greater benefits to investors in the form of better contribution rates to pension plans and lower premiums for insurance.[25] The end result is likely to be the presence of several funds from contractual savings institutions which could then be channelled through capital markets to finance investment in economic and social development projects.[26]

The report postulated that the development of efficient capital markets in Egypt and the privatisation of the public sector are reinforcing each other.[27] Revitalising

[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] See World Bank Report No. 16207-EGT, "Arab Republic of Egypt, Country Economic Memorandum, Egypt: Issues in Sustaining Economic Growth", Volume III.
[22] *Id.*, at 65.
[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] *Id.*
[27] *Id.*

HeinOnline -- 15 Arab L.Q. 8 2000

the capital market will provide more options for divestiture, while privatisation increases the supply of securities in the market, thus providing the securities market with more depth. Finally, the World Bank's report predicted that the deepening of Egyptian capital markets, as a mirror and increased market capitalisation to GDP, accompanied by increased liquidity in the form of higher turnover to market capitalisation, and less concentration of market activity on a small number of stocks, would enable Egyptian capital markets to absorb the expected increase in portfolio investments from both domestic and, hopefully, foreign sources.[28] This scenario developed by the World Bank is expected to protect the Egyptian economy from the drastic movements of asset prices.[29]

Revitalising capital markets in Egypt

President Nasser's death in September 1970, seemed to many observers to be the end of the socialist régime, the state hegemony and the control of the financial market. It seemed to be the beginning of the end of the dominant role of the Egyptian Central Bank and arbitrary decisions regarding determining the prime interest rate in the domestic market and the price of the Egyptian currency *vis-à-vis* other international currencies. After 15 years of state hegemony, the Egyptian Central Bank did not have effective tools of monetary policy, such as affecting resources in the system to influence money supply and hence, interest rates.[30] The three principal tools of control available to the US Federal Reserve Board such as changes in the reserve requirements; changes in the discount rate; and the open market operations committee,[31] did not exist (or were not available) to its Egyptian counterpart (the Egyptian Central Bank). After all resources had dried up, the Egyptian Central Bank did not have any choice but to print more Egyptian currency, thus increasing inflation. The Egyptian Socialist Government stopped issuing Government Securities since 1961, and relied heavily on Certificates of Deposit with a guaranteed inflated interest rate of 14 per cent issued by the Egyptian National Bank to stimulate local savings. Interest rates were determined by the Egyptian Central Bank's governor (who is a political appointee of the President), without taking into consideration the most fundamental components of the interest rate, which are the compensation for the time value of money, compensation for volatility risk and the "liquidity" or "illiquidity" premium.[32] Despite the dominant role the Egyptian Central Bank played during the socialist régime of President Nasser, it kept the centres of the Egyptian stock exchanges, *Bourseht-Al Awrak Al Maliah*, open (as a political stick to the West, particularly the USA) and Egypt did not become a totally socialist régime like the Soviet Union and countries of the Eastern Block.[33] And the private sector (controlled by the

[28] *Id.*
[29] *Id.*
[30] Bodil Dickerson, *et al.*, *Introduction to Financial Management*, 90 (4th ed. 1995).
[31] *Id.*
[32] See Klein, *supra* note 2, at 303.
[33] See Hassan, *supra* note 13, at 88.

HeinOnline -- 15 Arab L.Q. 9 2000

Government) continued to have room to contribute to the national economic and social development plan. Hence, President Nasser continued to get foreign aid (in the form of financing of some projects) from the USA and other Western European Countries and at the same time from the Soviet Union during the building of the Aswan High Dam and the iron and steel industry at Hilwan near Cairo.

In 1974, when President Sadat of Egypt wanted to reorient the Egyptian economy toward the West, the Egyptian Parliament passed Law 93 of 1974 (which was known as the Open Door Economic Policy) ("ODEP"). This Law was designed to encourage private investments – initially Arab and foreign capital, but ultimately Egyptian funds as well (Law 138, No. 32/1977).[34] It allowed foreign banks to establish branches in Egypt, or to enter into joint banking ventures with state-owned counterparts.[35] After the passage of Law 93 of 1974, joint stock companies started to proliferate and Egyptian and Arab capital flow came from Egyptians working in the Arab oil exporting countries (during the skyrocketing oil prices that followed the October 1973 War and the oil embargo against the West).[36] Millions of Egyptians migrated to the oil-rich countries. They earned, saved, and remitted billions of dollars from the mid-1970s onward.[37] Oil-rich countries or their respective development banks, such as the Kuwait Development Fund and OPEC Development Fund, also extended grants and loans to Egypt. Saad Eddin Ibrahim of the American University in Cairo estimated that approximately $3 billion annually poured into Egypt from these two sources alone, and Western foreign aid, especially from the US, averaged about $2 billion a year (the peace dividend with Israel, or Egypt's reward for signing a separate peace treaty with Israel).[38] It appeared to be a wise decision for the Egyptian Central Bank to keep the *Bourseht-Al Awrak Al Maliah* (stock exchange) open, during the socialist régime even though it did not cover its operating expenses.[39] When the remittances of Egyptian workers in the oil-rich Arab countries started to flow back home, they were targeted by Egyptian entrepreneurs in the capital market. Some of the new venture capitalists class were members of the old bourgeoisie class defeated by former President Nasser's socialist régime, and some of them were members of the new Islamic banking movement started in Egypt since 1977.[40]

Venture capitalists of both groups were encouraged by the passage of Law 157 of 1981 which organised the limited liabilities companies and Law 154 of 1981 which organised the joint stock companies. These aforementioned Laws included tax exemption for owners of the stocks and bonds issued for companies registered at the Egyptian *Bourseh* (stock exchange). Thus, the Egyptian *Bourseh* was activated again and was a healthy sign of an emerging open market economy which could

[34] See Ibrahim, *supra* note 3, at 138.
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] *Id.*
[39] See Hassan, *supra* note 13, at 88.
[40] See *Middle East Executive Reports* 9-15 (1995).

HeinOnline -- 15 Arab L.Q. 10 2000

mobilise domestic and foreign capital markets for economic and social development projects.[41] The Egyptian Government, like most governments in emerging market economies, was apparently looking to domestic markets to help fund massive development projects. The Egyptian domestic banking system was unable to cope with the demand for long-term funds which such projects generate.[42]

Revitalising Egyptian capital markets seemed to Egyptian policymakers during this period an opportunity for raising long-term resources and channelling them to projects of economic and social development[43] (and/or infrastructure-related projects).[44]

Legislating in Egypt: a unique approach to the capital markets

The Egyptian legislature seemed to be intentionally delaying the passage of a new Capital Markets Law. Law 43 of 1974, did not include among its articles the capital market, or its operations under the new régime, or any capital investment instruments. This article argues that the aforementioned inaction by the legislature was in many ways a wise approach. In fact, many of the countries which succeeded in stimulating foreign investors to their capital market did not enact special laws to govern the treatment of foreign investment (including investment in capital market) in their territories.[45] These countries only followed the broad policy of encouraging foreign investors, in the form of FDI or investment in the capital market. Among these countries are Taiwan, Singapore and Hong Kong. There was a fear of creating another bureaucracy to enforce new legislation which would turn off potential investors, both Egyptian and foreigners, plus the added cost associated with creating such administrative bodies. Furthermore, adding the enforcement of new laws to the already overburdened "Investment Authority", would possibly hinder it from performing its original responsibility of approving new FDIs in Egypt.

It seems that Egyptian legislatures were waiting for the Egyptian capital market to be developed and matured (in the context of the new economic realities) in its own way rather than by crippling it with regulations which may pre-empt any attempts to revitalise it.

The unintended consequences of the abovementioned approach to the capital market in Egypt, along with the rise of the Islamic movement, was the legal presence of *Islamic deposit taking companies*. The Islamic companies, according to *The Financial Times* (London) analysis prospered by offering depositors much higher rates of return than the Egyptian banks.[46] These institutions were widely accused of operating "pyramid" schemes whereby they paid dividends from banks

[41] See Hassan, *supra* note 13, at 88.
[42] See World Bank, *supra* note 15, at VII.
[43] *Id.*
[44] *Id.*
[45] Ibrahim F. I. Shihata, "Recent Trends Relating to Entry of Foreign Direct Investment", 4 ICSID Rev (1994).
[46] See *The Financial Times*, "Fraud Trial Against Cairo Financiers Begins" (26 Feb. 1990).

HeinOnline -- 15 Arab L.Q. 11 2000

lodged by new depositors. These new deposit taking companies are not incorporated as joint stock companies, nor do they issue stock or have boards of directors in the legal sense of these terms,[47] according to Enid Hill of the American University in Cairo.[48] Rather, the depositors are considered investors who are "sleeping partners", in a *Mudaraba* partnership.[49] These enterprises appeared as gigantic monoliths operating virtually outside the control of the Egyptian banking laws and other capital markets laws existing before the 1960 adoption of the socialist ideology.[50] Al Rayan and Al Sherif Islamic deposit taking companies promised large returns for investors, well over "20 per cent" and these were attractive to Egyptian workers abroad and the general population at home. They dealt in both foreign and Egyptian currency. Not only does this new enterprise represent yet another means whereby Egyptian workers' remittances remain outside the state's financial institutions, but also, they seem to have succeeded (where the Government has never been wholly successful), in motivating ordinary citizens to commit their savings, which in composite, can be used as investment capital.[51]

The Egyptian Government found itself in something of a "Catch 22" situation.[52] Because these Islamic institutions operate outside of the laws governing financial institutions, for all practical purposes there are no legal protections for depositors. Should these companies go under, the Government would have to confront myriad citizens with grievances demanding redress.[53] Nevertheless, there is fear that if controls are legislated, the vast amounts of foreign currency these companies reportedly have abroad (estimated in billions), will be forever lost to Egypt. Furthermore, should new controls cause these companies to "fold their tents and quietly steal away", Egyptian investors will also blame the Government. Some of these companies, it is reported, invested and lost heavily in the European gold market.[54]

Trust in these new investment institutions was promoted unintentionally by members of the Egyptian Government. For example, front page photographs appeared in the Government's own newspapers of Dr Moustafa Al Saled, the Minister of Economic Affairs (the equivalent to the US Secretary of the Treasury), with owners of these companies (Al Rayan), and/or visiting some of their factories. When depositors started to demand their promised profits, they discovered that these companies did not have enough liquidity to pay them. Most of their capital was tied up in risky investments overseas in many countries, mostly in Europe. After more than 15 years of operations with the tacit approval of the corrupt members of Government, *The Financial Times* (London) estimated the investors'

[47] Ibrahim M. Oweiss, *et al.*, *The Political Economy of Contemporary Egypt* 255 (1990).
[48] *Id.*
[49] *Id.*
[50] *Id.*, at 254.
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] *Id.*

HeinOnline -- 15 Arab L.Q. 12 2000

loss at two billion Egyptian pounds, equal to 700 million US dollars.[55] On 26 February 1990, the Egyptian authorities arrested owners of Al Rayan Company, Egypt's biggest finance house.[56] Government trustee Mufoudh was appointed to liquidate the company's remaining financial assets in local Egyptian banks and abroad in diversified investments, some of it most risky.

Consequences of the Egyptian financial crisis

The aforementioned news which was wired all over the world's financial centres shook foreign investors' trust in the emerging Egyptian capital market. Egyptians working abroad (expatriates) and foreign investors quickly transferred their capital (of hard currency) to European and US Banks. The Egyptian Government found itself suddenly, during the early 1990s, in short supply of hard currencies necessary to purchase new equipment and supplies to upgrade the capabilities of the public sector factories. Upgrading the Egyptian public sector to acceptable international efficiency standards was a necessary measure during structuring the divestiture[57] in the road to privatisation required by both the World Bank and the IMF in the 1991 agreement.[58]

Egypt's privatisation program slowed significantly during this period (from 1990–1995). The Government's various explanations for this slow pace included: the difficulties of valuation; lack of foreign investor interest due to terrorist attacks on foreign tourists in Egypt by members of radical Muslim organisations; and the questionable absorptive capacities of the nascent Egyptian stock market.[59]

This article argues that the causes of the Egyptian financial crisis of the 1980s are more complex and in one way or another reflect the spillover effects of the global financial crisis of the 1980s. The *United States General Accounting Office Report* revealed "that in June 1982, US banks held less developed countries LDC debt equal to 211 per cent of US bank capital. LDC debt owed to the largest nine US banks was 323 per cent of capital".[60]

Levinson argues that:

> ... the strategy of the Treasury and the Fed was clear – gain time for the banks to rebuild their capital and keep the interest payments from the debtor countries current. The regulators could then continue to pretend that the Euro-currency loans were not in default. Loan reserves would not have to be increased, nor would current income be reduced or bank stocks lose value. In time, the banks would be able to absorb the loan losses without significant loss to their stockholders. For this strategy to work, the debtor countries had to

[55] See *The Financial Times*, *supra* note 46.
[56] *Id.*
[57] See International Finance Corporation, *Lessons of Experience Series, Privatization Principles and Practices*, 3-14 (1995).
[58] Ahmed Galal, *et al.*, *Building Bridges, An Egypt-U.S. Free Trade Agreement* 38 (1998).
[59] See The Arab World Online, *supra* note 10, at 4.
[60] See Levinson, supra note 6, at 3.

HeinOnline -- 15 Arab L.Q. 13 2000

be convinced that responsibility for the debt crisis lay primarily with them, that it was their bad economic policies that had led to the crisis, not the imprudent lending of the banks.[61]

This article argues that the crisis of the financial market of the 1980s in Egypt was partially triggered by the economic downturn on weak loan demand in the industrialised countries. Western banks, including US banks and European banks and other finance houses overloaded by the surplus petrodollars money launched a lending and investment services campaign to many of the developing countries (including Egypt), to seek higher financial returns than they were able to realise in their traditional markets.[62] It was quite natural that this proactive campaign be met by local (financially unsophisticated) entrepreneurs in the developing countries who lack experience with the international financial market dynamics such as Al Rayan Finance House in Egypt. As of today, owners of Al Rayan, Egypt's biggest Islamic Finance House, are still in jail, not based on conclusive evidence of fraud, but as a precautionary measure allowed under the Marshall Law of 1981 which is still valid today. The whole case is a big puzzle, much like the case of the Savings and Loan Scheme during President Bush's administration in the USA.

PLAYERS IN THE EGYPTIAN CAPITAL MARKETS: HOW WILL THEY INFLUENCE AND AFFECT IT?

The Capital Markets Authority (CMA)

The aforementioned financial crisis in Egypt has prompted the passage of Law 95 of 1992 and several subsequent executive amendments, including Decree Nos. 295, 447 and 397 of 1998.[63] These Laws, according to the World Bank's recent study, instituted reforms in four areas:

> (a) The strengthening of the regulatory capacity of the Capital Market Authority (CMA) by establishing a legal framework that provides a substantial degree of flexibility to enable the CMA to respond to changing market conditions; (b) the issuance of regulations covering all participants in the market, including brokers, investment managers, investment funds, and stock exchanges; (c) the reorganization and modernization of the stock markets, including the establishment of new trading systems and linkages between the Cairo and Alexandria stock exchanges; and (d) the improvement in disclosure rules including the development of accounting and auditing systems.[64]

One of the positive indicators is that the CMA has delegated many of the regulatory powers to the stock exchanges which have established rules and regulations that govern their members and operations.[65] The CMA, however,

[61] *Id.*
[62] *Id.*
[63] See Capital Markets Law, *supra* note 9.
[64] See World Bank, *supra* note 21, at 66.
[65] *Id.*

HeinOnline -- 15 Arab L.Q. 14 2000

continues to have the power to revise these rules and regulations.[66] The Egyptian stock market, however, is tightly controlled by the Executive branch of Government, since the Chairman of the Board of Directors is a political appointee, appointed by the Prime Minister with the approval of the President for a three-year term. Furthermore, according to Presidential Decree No. 51 of March 1997, the following representatives have been included in the Board of Directors:

(1) Representative of the Egyptian Central Bank selected by the Governor of the Bank;
(2) Representative from the CMA selected by the Chairman of the CMA;
(3) Two representatives from the Banking Industry Association (most of them are public banks) appointed by the Chairman of the Banks Association;
(4) Six representatives from the companies working in the commercial papers business elected according to the procedures specified by the Minister of Economic and International Co-operation.[67]

As the abovementioned composition indicates, there are four bureaucratic entities which have authority over this supposedly independent mechanism "*Bourseht-Al Awrak Al Maliah*". These are: the Office of the Prime Minister; the Governor of the Central Bank; the CMA; and the Office of the Minister of Economic and International Co-operation.[68] The bureaucratic dominance seems to be slowing down the pace of development of the Egyptian *Bourseh*. The Board of Directors of the Egyptian *Bourseh* (according to Law 51 of March 1997) has to get the approval of the CMA President within 15 days of any decisions made.[69] What also complicates the task of this board is having four civil servant members of the board who are watched and monitored by four Securities Agencies: the Agency of Administrative Central (which is controlled by the Army and police); the Ministry of Interior (the umbrella organisation of all internal securities agencies); the Egyptian Intelligence Service (sector of economic securities); and, finally, the illicit Gains Office (under the Ministry of Justice). No wonder that the Egyptian *Bourseh* and the Egyptian capital market are not developing as they should be compared to other emerging economies. Another area of criticism is that Egypt's accounting system is not consistent with international norms. The often arbitrary imposition of bureaucratic impediments (resulting from the over-representations of various parts of the Egyptian Bureaucracy and Securities Agencies) and the length of time which must be spent resolving them remain significant obstacles to increased private sector investment in Egypt.[70] Further criticism is that Law 95 of 1992 stipulates that any company wishing to make a public offering must obtain the approval of the Capital Markets Authority. However, it does not bind the Authority to a time frame to grant the approval.[71] This

[66] *Id.*
[67] See Hassan, *supra* note 13, at 108.
[68] *Id.*, at 109.
[69] *Id.*
[70] See The Arab World Online, *supra* note 10, at 10.
[71] *Id.*

HeinOnline -- 15 Arab L.Q. 15 2000

article argues that despite the above mentioned problems, the Egyptian capital market is growing and developing incrementally and gaining the confidence of local and international investors and international organisations.[72] In January 1997, for the first time, International Finance Corp. (IFC) included Egypt in its investable stock market indices which track the activity of the key emerging stock markets and are recognised as the world's premier source of information on these markets.[73]

During the same month, Standard & Poor's assigned investment grade ratings to Egypt, placed it in the same category as the Eastern European countries and emerging economies in Southeast Asia.[74] S & P assigned its triple "B" – minus long-term and "A-3" short-term foreign currency credit ratings to Egypt. It also assigned to Egypt its single "A" – minus long-term and "A-2" short-term local currency credit ratings, affecting approximately 34 billion Egyptian pounds (equal to $10 billion) of senior unsecured Egyptian pound dominated treasury bills and bonds.[75] In April 1997, the IFC announced it would establish a risk management facility (RMF) for the largest commercial bank in Egypt, the National Bank of Egypt (NBE). The IFC officials state that the new facility will allow the bank to offer its private sector clients medium and long-term fixed rate financing as well as a variety of risk management products. Under this new agreement, the *Middle East Executive Reports*, based in London, reported that under the new agreement, the RMF could permit the undertaking of approximately $400 million of risk management transactions, depending on the type of transactions.[76] In April 1997, Egyptian President Hasni Mubarak and US Vice President Al Gore agreed to explore the possibility of creating a free trade agreement ("FTA") between Egypt and the US.[77] Among the issues of negotiations are co-operation in the field of enforcement of security regulations between the two countries (Extraterritorial Application of the US Security Laws to Egypt and Extraterritorial Application of Egyptian Security Laws to the USA – reciprocities).[78] Finally, in that respect, Merrill Lynch, the largest US brokerage firm has received its licence to operate in Egypt. According to Merrill Lynch's analysis, "The Egyptian economy is expanding at a strong, sustainable 4–5 per cent per annum, and the challenge in the next few years is to complete the reform plan in order to gain 7–8 per cent annual growth".[79]

Islamic banking in Egypt

In Egypt today, the mood of the Egyptian masses is religious. Egypt of the 1980s and 1990s is more conservative and Islamic fundamentalism is still an operating

[72] See *Middle East Executive Reports* 7 (January 1997).
[73] *Id.*
[74] *Id.*
[75] See *Id.*
[76] See *Middle East Executive Reports* 7 (April 1997).
[77] See The Arab World Online, *supra* note 9 at 12.
[78] *Id.*
[79] See American Chamber of Commerce in Egypt, *Highlights on privatization in Egypt* (http://www.amcham.org.eg/summit/invest/story11.htm July 1999).

HeinOnline -- 15 Arab L.Q. 16 2000

force in the legal and social economic fabric of Egyptian society.[80] This legal and socio-economic characteristic is reflected in existing Egyptian law. The Civil Code, effective in 1969, instructs a judge to decide a dispute on the following basis:

(1) According to the applicable specific provision of the Civil Law (which is a modified version of the Napoleonic Code which was imposed on Egypt by France in 1876 as a part of the measures associated with establishing the mixed courts which have jurisdiction over cases involving foreigners, and during Egypt's financial crisis and indebtedness to France);
(2) In the absence of an applicable provision of law, then according to customs;
(3) In the absence of custom, then according to Islamic law; and
(4) In the absence of Islamic law, then according to principles of natural justice and rules of equity.[81]

This order of precedence was not expressly altered by the 1971 Egyptian Constitution, which provided that the principles of Islamic law are a principal source of legislation in Egypt.[82] The Constitution was specifically amended in 1979 (due to the rise of the Islamic movements which included the growing rule and importance of the Islamic banking and finance not only in Egypt, but around the Islamic world), and now provides that Islamic law is the principal source of Egyptian legislation. More than ever, Howard L. Stovall argued, modern Egyptian commercial law like all the Arab Islamic countries cannot be judged without an assessment of the influence of Islamic law.[83]

Ibrahim Shihata, Senior Vice President and General Counsel of the World Bank, argues in support of the presence of Islamic influence in the Egyptian legal environment of business, and that such influence should not send a negative alarm to potential US investors in the Egyptian capital market. He criticises the current Egyptian legal and regulatory system of investment and its bureaucratic approach, which is in fact in contradiction to the principles of Islamic jurisprudence (*usul-ul-figh)*. Shihata argues:

> In this context, legislative policy is intertwined with economic and social policies. Through legislative and regulatory action, economic and social policies are translated into rules and procedures, the effective application of which enables societies to achieve their objectives. Experience shows that successful legislative policies are those which are based on the presumption of permissibility, i.e., those which assume that prohibitions, limitations and approvals are the exception rather than the general rule. Interestingly, this presumption is one of the basic principles of Islamic jurisprudence (*usul-ul-figh*) which recognizes permissibility as the general rule. This principle seems nonetheless to be commonly ignored in many countries proclaiming Islamic law as the source of legislation.
>
> Allowing economic agents to work with a minimum degree of state intervention has long

[80] Howard L. Stovall, "Some Current Legal Issues Concerning Trade and Investment in Egypt", [1990] ALQ 124.
[81] *Id.*
[82] *Id.*, at 129.
[83] *Id.*

HeinOnline -- 15 Arab L.Q. 17 2000

been advocated in the Arab culture, most notably by the fifteenth century writings of Ibn Khaldun. Egypt did not need to learn this from the World Bank. This is not only good economics; it is also good law. Furthermore, it respects human dignity. It assumes goodness in people and relies more on *ex post* enforceable sanctions in case of violation of established rules than on the prior approval of every possible act. By keeping the limits to the minimum dictated by the exigencies of public interest, the state also ensures the effectiveness of the limits it introduces. Such effectiveness is often lost in systems based on the presumption of prohibition and burdened with excessive constraints. Drawing the right boundaries between state and market forces is one of the fundamentals of successful legislative policies, and it is also the underlying issue in any discussion on private sector developments.[84]

The same view of no contradiction between Islamic banking and modern principles of security is expressed by Zamir Igbal in his study where he argues in support of Islamic banking as a positive force in the Islamic and Arab capital markets, including Egypt. He states that:

While Islamic banking is not new, the term AIslamic financial system" is relatively new. Previously, the umbrella term "interest-free banking" was used for any and all commercial or monetary activity according to Islamic principles. Although the Islamic financial system is often summarized as "interest-free banking", this description by no means gives a complete picture of the system. A financial system based on Islamic principles not only is free of *riba* (which includes "interest" and is defined below), but also incorporates risk-sharing, encourages trade and entrepreneurship, discourages undue speculative behavior, and preserves the sanctity of contracts.

In Islam, the concept of a return on financial transaction is synonymous with "profits", but not with a fixed, pre-determined rate of return such as interest. The difference between "interest" and "return" is critical: Islam prohibits the former but encourages the latter. Islam does not prohibit a return on financial transactions, but it does require that such a return be based on the mutual willingness of the investor and the entrepreneur to share risk. There is no prohibition on using a notional expected rate of return to evaluate investment projects.

The basic principles of an Islamic financial system can be summarized as follows:

1. *Prohibition of riba.* Islam prohibits *riba*, which is any unjustifiable increase of capital whether in loans or sales. The scope of *riba* is much wider than just "interest", which in Western financial systems represents the opportunity cost of capital. All Islamic schools of thought agree that *riba* is not (as it is often perceived to be) simply usury. It is an amount that must be paid in addition to the principal of the loan, based on the time for which the loan is made, or the time for which payment of the loan is deferred. The consensus of opinion among Islamic scholars now is that the prohibition against charging interest extends to any and all forms of interest, including *excessive* interest and the indexing of capital (such as adjusting value for inflation or loss in purchasing power). More precisely, any positive, fixed, predetermined rate tied to maturity and the amount of principal (that is, guaranteed regardless of the performance of the investment) is considered to be *riba* and is prohibited.

[84] Ibrahim F.I. Shihata, *The World Bank in a Changing World, Selected Essays and Lectures* 514 (1995).

HeinOnline -- 15 Arab L.Q. 18 2000

2. *Risk-sharing.* By prohibiting a fixed, predetermined rate of return on financial transactions, the Islamic financial system closes the door on suppliers of funds becoming *creditors* and forces them to assume the role of *investors.* Both the owners of financial capital and the owners of human capital share business risks in return for sharing profits. In a conventional system, a creditor's risk is limited to the solvency risk of the business, but the creditor's reward (interest) is relatively insulated from the fluctuation in business operations – leading to an asymmetry in the risk and return profile.

3. *Money as "potential" capital.* In the Islamic financial system, money is treated as "potential capital" that turns into capital only when it joins with other resources, human or natural, to undertake a productive activity. Islam recognizes the time-value of money, but only when the money is acting as capital, not when it is "potential" capital.

4. *Prohibition of speculative behavior.* The Islamic financial system prohibits the undertaking of transactions that cause artificial and inflammatory price rises as a result of hoarding and feature extreme uncertainties, ambiguities and risks. All forms of gambling are prohibited. Further, a transaction should be free of uncertainty to the extent that the parties should have a knowledge and understanding of the terms of a contract, and also have reasonable control over their ability to honor the commitment.

5. *Sanctity of contracts.* Islam treats the honoring of contractual obligations and the disclosure of information regarding contractual agreements as a sacred duty. This feature eliminates or reduces the risk of asymmetric information (which allows one party to gain an advantage unfairly) and moral hazard (which may result in exploitation of less-informed parties).

6. *Activities that conform to the Shari'a.* In the Islamic financial system, the only activities that may be undertaken as investments are those that do not violate the rules of *Shari'a* – the rules and laws governing the economic, social, political and cultural aspects of Islamic society. For example, investments in businesses dealing with alcohol or gambling are unacceptable.

Basic securities instruments in Islamic banking

Trust financing (modarabah). This is identical to an investment fund where managers with appropriate skills take the responsibility of managing a pool of clients' funds. The agent-manager has relatively limited accountability in terms of outcome, while having sufficient incentives to perform. Fixed amounts of profit for either clients or agent (other than the pre-agreed salary or salaries of the agent) are not permitted. However, there is no objection to a predetermined fixed ratio of profit-sharing. Recent innovations to enhance liquidity have led to development of negotiable certificates that carry a share in such funds. For large projects, a syndication of funds can be formed.

Equity participation (musharika). This is analogous to a classical joint venture. Both entrepreneur and investor contribute to the capital of the operation (including assets, technical and managerial expertise, working capital and so on) in varying degrees and agree to share the returns as well as the risks in proportion agreed upon in advance. Traditionally, this form of transaction has been used for fixed assets as well as working capital financing for both medium- and long-term durations. A wide range of variations

HeinOnline -- 15 Arab L.Q. 19 2000

is currently being practiced. Fully negotiable, tradeable and transferable shares or certificates can be issued for various maturities as a temporary partnership (similar to stock or mutual fund shares, which are a temporary equity partnership that one can buy or sell in the market).

Sales contracts (bay' mu'ajjal or deferred payment, and bay'salam or deferred delivery). In deferred payment sales, delivery of the product is taken on spot, but payment is delayed for an agreed-upon period of time. Payment can be made in a lump sum or in installments, provided there is no extra charge for the delay. Deferred delivery is similar to a forward contract, where delivery of a product is to be made in the future in exchange for payment on the spot market.[85]

The aforementioned arguments, do not mean that investing in Islamic banking's securities instruments are safe in Egypt. This article argues that The Capital Markets Law should be amended to include the Islamic banks security instrument and to regulate it in such a way that will encourage small investors who are not educated and financially sophisticated. Millions of Egyptian uneducated farmers and construction workers (Muslims), immigrated to Saudi Arabia to work in the Saudi agriculture and infrastructure development projects during the past 20 years. They earned enough to satisfy their basic needs and they had a little to save. Their religious beliefs made them trust only the Islamic banks near their village and the Islamic way of investment. After the financial scandal of Al Rayan, Egypt's biggest Islamic finance house, small investors in rural areas had no choice but to either invest in the informal economy in Egypt which is more risky, or spend their small savings on unnecessary luxury items and lavish consumption.[86] While there is no official information about the informal economy in Egypt and its various investment schemes, Egyptian economist, Ibrahim Owess of Georgetown University, believes it is sizeable.[87] The noticeable excess demand for US dollars in Egypt's black market is indicative of the presence of an informal economy and of the flight of the capital from the country. This article argues in favour of expanding the Egyptian Capital Markets Law jurisdiction over Islamic bank's financial instruments. In fact, encouraging investments in Islamic securities instruments, in addition to protecting it by anti-fraud rules, is likely to appeal to the majority of small investors in Egypt. New amendments along the lines of the US 1992 Small Business Initiatives will be helpful.[88]

Furthermore, the Capital Markets Law "should require that small entrepreneurs (in rural areas) must prepare and file a simplified disclosure statement (mini registration) with reasonable fees". According to these new amendments to the Egyptian Capital Markets Law, "Anyone who purchases unregistered securities from the Islamic banks has the absolute, unequivocal right to rescind that

[85] Zamir Igbal, "Islamic Banking Gains Momentum, Expands Market and Competes with Conventional Banking in the Arab States", *Middle East Executive Reports* 9–19 (January 1998).
[86] See Oweiss, *supra* note 47, at 29.
[87] *Id.*
[88] Mark R. Lee, *Securities Regulation Law-612-001*, Volume III, 557–559 (1999).

HeinOnline -- 15 Arab L.Q. 20 2000

purchase", which means getting the purchase money back in full.[89] If the financial securities instrument is sold at a loss, the purchaser (or small investor in rural areas) can sue for damages and the amount of the loss through a simplified process similar to the US Small Claims Court. Finally, there are definite business opportunities for US brokerage firms such as Merrill Lynch, Legg Mason and clearing houses and other US financial services to get into this market. Hopefully, the proposed Free Trade Agreement, "FTA", between Egypt and the USA will be ratified very soon by both the US Senate and the Egyptian Parliament to give US financial services priority over the European and Japanese, to compensate for the US investment in Egypt since 1978 (estimated at 2.3 billion in foreign aid).[90]

Courts in Egypt (and ADR)

Egyptian courts may not seem like friendly fora to business interests due to the influence of the socialism ideology and policies for almost 13 years under former President Nasser. In the 1970s, Nathan Brown argues that, the Egyptian Government changed its attitude toward business, because of a larger effort to attract foreign investment to the country.[91] Political bargaining between Western countries (particularly the US) and Egypt played a role in this shift.[92] Investment law in Egypt was changed to encourage arbitration.[93] Bilateral investment treaties between Egypt and the USA and other Western countries and Far East countries have been negotiated with the same effort.[94] Furthermore, external aid agencies such as the World Bank Group and the US AID and the EU, have sometimes threatened to withhold grants or loans unless arbitration clauses are included in funded contracts.[95]

Egyptian Arbitration Law 27 of 1994 grants contracting parties almost total latitude in the choice of forum and both procedural and substantive law.[96] The aforementioned Law is described by many observers and legal analysts from the West and East as a model law. It passed the Egyptian Parliament without major public controversy.[97] With the passage and enforcement of the 1994 Law, Egypt became the Arab state most supportive of arbitration.[98]

[89] James B. Arkebauer with Ron Schultz, *Going Public, Everything you need to know to take your company public, including internet direct offerings* 189 (1998).
[90] See Galal, *supra* note 58, at 8.
[91] Nathan J. Brown, *The Rule of Law in the Arab World, Courts in Egypt and the Gulf*, 223 (1997).
[92] *Id.*, at 232.
[93] *Id.*, at 94.
[94] *Id.*, at 95.
[95] *Id.*, at 96.
[96] *Id.*, at 97.
[97] *Id.*, at 98.
[98] *Id.*, at 99.

HeinOnline -- 15 Arab L.Q. 21 2000

Arbitration and settlement of disputes in the Egyptian "Capital Markets Law"

Articles 50 to 62 of the Egyptian Capital Markets Law describe in detail the method of issuing a complaint from decisions made by the Minister of Economics (who is overseeing the CMA and the Egyptian *Bourseh*)[99] and the President of the CMA (who is overseeing the activities of the Egyptian *Bourseh*.) The most encouraging feature of these articles is that Article 52 states that "settling and resolving the disputes and litigations resulting from applying the provisions of the present law between parties dealing in the field of securities shall be exclusively through arbitration". Taking out this vital part of the emerging Egyptian economy from the jurisdiction of civil courts is a wise step taken by the Egyptian legislature. Civil disputes before Egyptian courts can take at least seven to 10 years before settled. Furthermore, the progressive court fee structure in Egypt makes initiation of litigation a far more expensive proposition for those involved in larger-scale disputes (particularly institutional investors).[100] In general, in a civil suit, court officials are responsible for estimating the value of the goods, or services at issue in a dispute; court fees are fixed at a proportion of the value of the case.[101] In large security disputes, in the case of institutional investors, it would not be impossible for court fees to be several million Egyptian pounds.[102] Article 59 of 1992 has put a ceiling on the arbitration fees at 100,000 pounds. This is a positive indicator.

Another positive indicator (which is good news for the critics of the rules of the Egyptian civil and commercial procedure law), is that Article 55 states that:

> The Arbitration Body shall examine the litigation summarily without being restricted by the rules of the civil and commercial procedure law, with the exception of those connected with guarantees and basic principles in prosecution. The Arbitration Body shall issue its ruling within a period not exceeding one month.[103]

This article argues that the article is likely to give the Arbitration Body the freedom to apply the clauses of the bilateral investment treaties, and the widely acceptable practices in the security and capital market industries. Furthermore, requiring that the Arbitration Body shall deliver its ruling in one month will lead to more confidence in the Egyptian investment climate.

The extraterritorial application of US and Egyptian securities laws

In February 1996, the "CMA" signed an agreement with the US SEC for technical assistance and information exchange.[104] This Memoranda Of Understanding (MOU), furthers the US–Egypt Joint Economic Partnership and creates a framework for technical assistance and enforcement co-operation.[105] On 11 April

[99] *Id.*, at 100.
[100] See Capital Markets Law, *supra* note 9, at 25–28.
[101] See Brown, *supra* note 92, at 225.
[102] *Id.*
[103] *Id.*
[104] See Capital Markets Law, *supra* note 9, at 25–28.
[105] See Brown, *supra* note 92, at 225.

HeinOnline -- 15 Arab L.Q. 22 2000

1997, senior level Egyptian security regulators and securities market officials (from the Egyptian *Bourseh*) attended the SEC Seventh Annual International Institute training for two weeks of training.[106] The two week executive level Institute is the cornerstone of the SEC's International Technical Assistance Program.[107] The SEC's Technical Assistance Program helps regulators of foreign securities markets to develop regulatory structures that promote investor confidence. Legal observers from the US and Egypt are speculating that this broad range of co-operative activities in mutual information and in law enforcement is a tacit agreement on the reciprocity of extraterritorial application of US and Egyptian securities laws. The Egyptian and US Government officials did not deny this interpretation and the two Governments are co-ordinating their positions in the activities of the International Organisation of Securities Commissions (IOSCO).[108] As a result of the close working relationship between Egypt and the USA in the areas of information exchange and law enforcement to protect US and Egyptian markets from cross border fraud, the US Chamber of Commerce in Cairo, Egypt made the following statement:

One of the many benefits of economic reform is the revival of the Egyptian capital market, which is regarded as vital to the development of the Egyptian economy. The Egyptian stock market has achieved a high level of success, reflected in the flow of privatization shares and the resulting increase in the volume of traded shares, the increase in the efficiency of securities companies working in the capital market, and increasing overall stock market efficiency. Finding solutions to hindrances to trading activity has contributed greatly to this success.

Traded stock value reached 3236.1 million pounds during the first half alone of 1996, roughly equivalent to the annual traded value for all of 1995. This increase in activity can be explained by the acceleration of the privatization program in the first half of 1996, when many public company shares were offered for sale and oversubscribed.

The intention of the Egyptian government is to offer as much as 70% of companies for sale in order to anchor investors or a group of investors by direct sales methods. This will also enhance demand for such companies, thereby raising their share prices. The new Egyptian privatization policy is allowing for sale on the stock market as much as 60% of the total shares (valued at around 480 million pounds) of six companies (Kafr El Zayat for Pesticides, Egyptian Starch & Glucose Manufacturing Company, Misr Oils & Soaps, Port Said Containers & Handling Company, and Development & Popular Housing Company), with 10% of the said percentage reserved for company workers and the rest to be sold to private investors and mutual funds. With the increase in market activity, it has become necessary to confront the elements that pose obstacles to such activity. Lack of transparency and non-availability of information are often cited as hindrances to the market. However, companies are now becoming more accessible, using the Capital Market Authority information system, an up-to-date system that guarantees reliable low-cost information and data on companies listed on the market.

There is, however, still a need to communicate the availability of this service to international markets and foreign investors. The new settlement and clearance system that came into

[106] *Id.*

HeinOnline -- 15 Arab L.Q. 23 2000

effect last August should lead to the abandoning of the manual safekeeping system, which also hindered stock market activity. The new system will allow brokerage firms to work directly from their respective offices through computer lines connected to the stock market. Eventually, clearance responsibilities will be transferred to securities firms. This is expected to eradicate all problems that once affected the speed and accuracy of settlement and clearance operations. Under this system, each brokerage firm working in the field of securities' settlement and clearance would be required to keep a bank account with either Banque Misr or the National Bank of Egypt, who will act as the final settlement parties, carrying out all settlement and clearance operations using their facilities. The ultimate goal is the complete cancellation of the manual system. There is no doubt that the Egyptian stock market is beginning to reap the fruits of economic reform, with demand from Arab and foreign investors accounting for 38% of total stock market activity, thereby proving the stability of Egyptian economic policies with regard to the economic reform program.[109]

SIMILARITIES AND DIFFERENCES BETWEEN THE US AND EGYPTIAN SECURITIES LAWS AND JURISPRUDENCE

The concept of security in the USA

The USA Securities Act s. 2 (a)(1) and Exchange Act s. 3 (a)(10) each define a "security" in both specific and more general terms.[110] Thus, there is not a single test for determining what constitutes a security. There is first a specific test, followed by a more general test.[111] The purpose of the two-part test, according to the Congressional statement, was to include within the definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.[112]

[107] *Id.*

[108] See Capital Markets Law, *supra* note 9, at 26.

[109] See The Arab World Online, *supra* note 10, at 12.

[110] Richard W. Jennings *et al.*, *Federal Securities Laws, Selected Statutes Rules and Forms*, 2 (1998). Section 2(1) of the 1933 Act defines a *security* as "any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security ... or, in general, any interest or instrument commonly known as 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing".

[111] See Jennings, *et al.*, *supra* note 1, at 306.

[112] This definition broadly incorporates the many types of instruments that fall within the concept of a security. Furthermore, the courts generally have interpreted the statutory definition to include non-traditional forms of investments. In *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681 (1985), the Supreme Court adopted a two-tier analysis of what constitutes a security. Under this analysis, the court will presumptively treat as a security a financial instrument designated as a note, stock, bond, or other instrument specifically named in the Act. On the other hand, if a financial transaction lacks the traditional characteristics of an instrument specifically named in the statute, the court has used a three-part test, derived from *Securities and Exchange Commission* v. *W.J. Honvey Co.*, 328 U.S. 293 (1946), to determine whether that financial transaction constitutes an investment contract and thus a security. Under the *Honvey* test, a financial instrument or transaction that involves (1) an investment in a

HeinOnline -- 15 Arab L.Q. 24 2000

The list of specific instruments includes any "note", "stock", "bond", "debenture", "certificate of interest" or participation in any profit-sharing agreement – investment contract.[113] In the law made by *SEC* v. *C.M. Joiner Leasing Corporation*, the US Supreme Court, for the first time considered the application of the statute to the sale of interests in oil and gas leases coupled with the promise by the seller to drill test wells so located as to discover the oil producing possibilities of the surrounding land. Jackson J. noted that the definition was similar to that found in many state "Blue Sky" laws and considered what rules of statutory construction might serve to ascertain the legislative intent. Jackson J. argues that the Act should be strictly construed.[114] In applying the two tests for the security under s. 2(a)(1) to the facts, Jackson J. first applied the specific instruments test to determine whether the oil leasehold interests were included within the specifically designated instruments. Since the list of specific instruments did not include dividend interests in oil and gas, he then proceeded to the second test by considering the terms of a more variable character, specifically "investment contract".[115] Jackson J. points out that the leasehold interests were sold on the condition that the purchasers would share in any appreciation in value of their lease interests if oil were discovered on adjacent land. He concluded that their leaseholds constituted "investment contracts", and therefore, were "securities".[116]

In recent years (as early as 1982), some federal courts, engaging in an extreme form of judicial activism, reversed this process and began to apply the test for investment contracts in the law made by the Supreme Court in *SEC* v. *W.J. Howey Co.*, to specific instruments expressly enumerated in the statutory definition of a security.[117] This Court found out that the new economic reality poses that certain specifically enumerated instruments should be considered non-securities, and hence placing such (securities) outside the jurisdiction of the Securities Act s. 2(a)(1) and the Exchange Act s. 3(a)(10).[118] This article argues (in agreement with prevailing literature) that these courts seized upon the "economic reality" test, a test formulated to "afford the investing public a full measure of protection", and changed it into an exception to the definition of a security, thereby narrowing the scope of the statute.[119] The unintended consequences of the aforementioned interpretation of the statute is that many investors were deprived

contd.
common venture (2) premised on a reasonable expectation of profit (3) to be derived from the entrepreneurial or managerial efforts of others constitutes an investment contract. In certain circumstances, investments in limited partnership interests, citrus groves, whiskey warehouse receipts, real estate condominiums, cattle, franchises, and pyramid schemes have been held to be securities under this test.

[113] See Jennings, *et al.*, *supra* note 1, at 307.
[114] *Id.*, at 308.
[115] *Id.*
[116] *Id.*
[117] *Id.*, at 307.
[118] *Id.*
[119] *Id.*

HeinOnline -- 15 Arab L.Q. 25 2000

of the registration, disclosure and anti-fraud provisions of the Securities Acts.[120] This has produced a flood of cases holding that "notes" and "stock" were non-securities in the particular context on the basis that "economic realities" justified reinterpreting the scope of the statute.[121]

The concept of security in Egypt

The Egyptian Capital Markets Law 95 of 1992 and its executive regulations did not define explicitly or in more general terms what constitutes a security. This article argues that this was a wise and more pragmatic approach taken by the Egyptian legislature in a time of change. One opinion is that in the absence of a specific definition of security in the Capital Markets Law, the definition of the Egyptian commercial law of security can be applied.[122] Ahmed Sharif Al Deen, a well-known Egyptian jurist, argues that the Egyptian jurisprudence is nearly settled upon equating commercial papers with securities.[123] Hence, securities can be defined according to this view as any commercial papers, i.e. stocks of joint stock companies and limited partnership companies formed to raise capital, group of holders of debentures, finance bonds, investment funds, which may be established for the purpose of investing savings. This article argues that the above scope of securities can be broadly construed to include basic financial instruments in Islamic banking, such as trade with mark up or cost plus sale (*murabaha*), leasing (*ijara*), trust financing (*modarabah*), equity participation (*musharika*), and sales contracts (*bay'muajjal*) or deferred payment, and (*bay'salam*) or deferred delivery.)[124] The aforementioned interpretation of securities to include Islamic banking instruments would make it under the jurisdiction, registration and disclosure requirement of the Capital Markets Law, hence the investors in these institutions will be protected and the Al Rayan financial crisis and any similar to it would be avoided in the future.

In a time of economic transition and revival from the socialist régime and the presence of new economic realities, the Egyptian legislature chose to leave the options open for developing new instruments or new security devices to raise capital from both domestic and foreign investors for its new privatisation program recommended by the World Bank, the IFC and the US Agency for International Development and the US SEC (through the technical assistance program). As a result of this open option approach to securities, the American Chamber of Commerce in Cairo, Egypt reported that:

> ... the take off of the Egyptian stock market in 1996 created the necessary climate for establishing new investment vehicles for small retail and large institutional investors alike. To date, 16 local mutual funds have been established in addition to five off shore

[120] *Id.*, at 308.
[121] *Id.*
[122] Ahmed Sharaf Eldin, *Business Law, Legal Aspects of Commerce and Economy*, 139 (1998).
[123] *Id.*
[124] See Igbal, *supra* note 85, at 13–14.

HeinOnline -- 15 Arab L.Q. 26 2000

international country funds investing in Egyptian securities. These country funds are listed on the London, Dublin and Luxembourg stock exchanges.[125]

This article argues that as a result of the open option approach of the Egyptian legislature to securities, the following securities mechanisms were developed to raise capital. The American Chamber of Commerce in Cairo reported that:

The use of IPOs by private companies to raise new capital has emerged as a trend on the stock exchange. Solid Egyptian private companies like the Olympic Group and Oriental Weavers have participated. Five Egyptian companies have shares listed internationally as global depository receipts, and more are on the way. The Prime Minister has allowed the state pension fund to invest up to 30 per cent of its £E75 billion capital in stocks. The first transaction took place in the third quarter of 1997, when it bought two million shares of America Cement. This move, part of a policy to increase returns, is expected to give a boost to the effort to shift capital from the public sector to the more productive and efficient private sector. The pension fund has also taken the largest stake, £E 200 million, in the Egyptian International Fund, new closed-end fund with an authorized capital of £E 1 billion.[126]

The Egyptian legislature's position of not defining explicitly the meaning of securities and what constitutes an investment instrument in the Egyptian capital market seems to be moving toward the position of Jackson J. in the US case *SEC* v. *C.M. Joiner Leasing Corporation.* [127] Jackson J. states:

In the Securities Act, the term "security" was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds, and stocks, are pretty standardized and the name alone carries well-settled meaning. Others are of more variable character and were necessarily designated by more descriptive terms, such as "transferable share", "investment contract", and "in general any interest or instrument commonly known as a security". We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. Instruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description. However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as [a] matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts", or as "any interest or instrument commonly known as a security".[128]

Finally, this article argues that both the US securities laws and jurisprudence and the Egyptian capital markets laws and jurisprudence, share a common perception of the internationally recognised rationale of security presented by

[125] See US Chamber of Commerce in Egypt, *supra* note 110.

[126] *Id.*

[127] In *Securities and Exchange Commission* v. *C.M. Joiner Leasing Corporation*, the Supreme Court for the first time considered the application of the statute to the sale of interests in oil and gas leases coupled with the promise by the seller to drill test wells so located as to discover the oil-producing possibilities of the surrounding land. Jackson J. noted that the definition was similar to that found in many state "Blue Sky" laws and considered what rules of statutory construction might serve to ascertain the legislative intent.

[128] See Jennings *et al.*, supra note 1, at 307.

HeinOnline -- 15 Arab L.Q. 27 2000

Philip R. Wood in his work where he states that security encourages capital (e.g. enterprise finances); security reduces the cost of credit (e.g. margin collateral in markets); he who pays for the asset should have the right to the asset; security is defensive control (e.g. especially in the case of project finance); and security is a fair exchange for credit.[129]

Information disclosure

This article argues that the Egyptian Capital Markets Law has followed the 1933 Act as a model law in terms of information disclosure. Article 40, Paragraph 2 of the executive regulations of the Egyptian Capital Markets Law states:

> No invitation for public subscription shall be authorized including public business sector companies and public sector companies except on the basis of a publication to be approved by the Authority (CMA) and on the forms to be provided or approved thereby, providing it shall be clearly mentioned therein that the Authority's approval of the publication is not an approval of the activity subject at the trade feasibility the publication or the ability of the project to achieve specific goals.[130]

Article 40 of Law 95 of the Egyptian Capital Markets Law followed the US Securities Act of 1933 by mandating such requirements for all firms. Furthermore, Articles 42, 43, 44 and 45 of the Capital Markets Law dealing with the publication for subscription (prospectus) at the time of founding the project, announcement published for subscription prospectus to capital increase share, and publications for subscribing to other securities, issuing shares in return for a real portion whether on founding the project, or increasing the capital, are very much in line with s. 2(10) of the 1933 Securities Act[131] and s. 2 of the Securities and Exchange Act of 1934.[132] The Egyptian Capital Markets Law, however, did not follow the US Securities Act of 1933 in terms of Regulation A (conditional small issues exemptions), Regulation D (rules governing the limited offer and sale of securities without registration), and Regulation E Exemption (for securities of small business investment companies). This was a reasonable position taken by the Egyptian legislature due to the special circumstances of the Egyptian capital market, and the circumstances surrounding the financial scandals of Al Rayan in the 1980s, Egypt's biggest finance house prior to the passing of the Capital Markets Law. The Egyptian legislature chose a very cautious approach by making all activities of issuing and raising capital under the jurisdiction and scrutiny of the CMA by requiring mandatory registration, Chapter 1, Articles 1, 2, 3, 4, 5, 6 and 7.[133]

[129] Philip R. Wood, *Law and Practice of International Finance, Comparative Law of Security and Guarantees*, 3 (1995).
[130] See the executive regulations of the Capital Markets Law (Art. 40, p. 2, 1948) (Egypt).
[131] See Jennings, *et al.*, *supra* note, at 134.
[132] *Id.*, at 468.
[133] See the executive regulations of the Capital Markets Law (s. Art. 1, 2, 3, 4, 5, 6, 7).

HeinOnline -- 15 Arab L.Q. 28 2000

Liability of misleading statements

The Egyptian legislature treated misleading statements very seriously. The Capital Markets Law, Law 95 of 1992, and its executive regulations dealt in both general and specific terms of misleading statements in Chapter 3 (announcement), Articles 221, 222, 223, 234, 225 and 226.

Article 221 states:

Each announcement to be issued by the company shall be qualified by its honesty and precision. It shall comprise all information required to be explained or which is considered necessary according to the subject of the announcement and the nature of the public to whom it is addressed, in order to enable an understanding of it and evaluating its subject. The company shall not conceal any facts or substantial information in a way that might affect taking sound decisions by its clients or by any individual among the public to whom the announcement is addressed, or create any type of misguidance or confusion within the public. The announcement shall not comprise any exaggerated statement or suggestion with a misleading effect.

The announcement is meant to address to the public information or materials intended to be published or circulated in any form and on any occasion via an audio or visual local, foreign, written or broadcast media or carried through any electronic or other methods. The "Public" shall mean persons that are not defined beforehand and those having no link with the company, its directors, or its workers by former relations, or with learning about any announcement made by the company.[134]

[134] *Id.*, at 102, Article 222 states that "The company shall observe precision and discretion in all its works. Nor shall it carry out any of the following work:

1. Receiving any pay or charges of any kind, or stipulating that the company's clients should dispose in a specific manner, when rendering services announced by the company and extended free of charge.
2. Using unjustifiably any cautioning statements in connection with any securities, if they constitute some kind of misleading effect.
3. Concealing differences of significance when carrying out comparisons between the different securities or between the performance of different companies".

Article 223 states that "The announcements made about floating or selling the securities and the reports or research works as published about the securities, their stock market, or the companies issuing them shall comprise the name of the quarter preparing the announcement or research, the date of its publication for the first time in case of repetition of the publication, and the main financial data about the companies issuing the securities, or with which the announcement is connected, according to the rules to be set by the Authority".

Article 224 states that "The company shall verify the correctness and precision of the information and data included within the announcement made thereby and shall not repeat the announcement without ascertaining that the information as set forth therein, is still valid each time it is published, broadcast or advertised in any other form. The company shall in particular ascertain the fact of the prices of securities as mentioned in the announcement and indicate whether they are closing prices or circulation rates, or nominal values".

Article 225 states that "The company, its directors or its workers shall not announce about the company's obtaining of any prize or certificate of any kind, or obtaining thereof by any of its directors or workers, except after ascertaining that nothing has been paid in exchange therefor, against its obtaining to the quarter granting the prize or certificate. The nature of this quarter shall also be indicated in the same announcement.

In all cases, the announcement shall specify that granting the prize or certificate expresses only the view of the quarter offering it and does not mean guaranteeing the realization of any financial return".

HeinOnline -- 15 Arab L.Q. 29 2000

This article argues that in the absence of an article or articles in the Egyptian Capital Markets Law (or its executive regulations) dealing with the burden of proof, Evidence Law 25 of 1968 will be applied.[135] According to the broad interpretation of this Law, the plaintiff must prove reliance on the misstatement, and must prove a misrepresentation of fact and not merely of opinion according to Article 1 of Law 25 of 1968, the plaintiff should prove that the material facts of the case are relevant directly to his claims and it has been accepted by the court as evidence.[136] The aforementioned position of the Egyptian legislature in dealing with burden of proof is very much consistent with the prevailing views in the US jurisprudence.[137] This is sometimes very costly and time consuming to the investor if the court decides to invite expert witnesses. Egyptian judges are different from US judges, in that they are at the centre of the civil law system.[138] Not only do they issue the final decision, but they decide everything else related to the matter at hand as well.[139] There are no rules of evidence in the Egyptian laws, no cross examination, and no objections (as in the US system), because judges have sole discretion to decide what evidence to accept; what questions to ask of the witnesses, and what behaviour to tolerate in the court room.[140] There are no juries in the Egyptian system (as in the US system) to decide factual questions because the judges have been trained and chosen to play this role.[141] Misleading statements by a corporate officer or any professional involved in the preparation of the

contd.
Article 226 states that, "The company shall not announce about the existence of research units therewith, or the ability to effect technical studies connected with the securities, unless this is actually carried out thereby and is available therewith. If the announcement as made by the company comprises any data, tables, graphs, figures or specific information, the company announcing it shall indicate the source of this information if it has not prepared it, by itself".

[135] Ahdul Manaem Hassany, *Egypt's Mousuha for Legislation and Jurisprudence*, 202 (1986).

[136] *Id.*

[137] See Lee, *supra* note 88, at 10–12.

[138] Richard A. Danner and Marie-Louise Bernal, *Introduction to Foreign Legal Systems*, 5 (1994).

[139] *Id.*

[140] *Id.*

[141] See the Capital Markets Law, *supra* note 9, at 28–29; Capital Markets Law 95/1992: Article 63, paragraphs 3, 4, 5, 6, and 7: "Subject to any stricter penalty as prescribed in any other law, the following shall be liable to a penalty of imprisonment for a period not exceeding Five Years, and a Fine of not less than Fifty Thousand Pounds and not exceeding One Hundred Thousand Pounds, or either penalty:

3. Whoever intently records in the subscription bulletins, the incorporation papers, the license or other reports or documents or announcements connected with the Company incorrect data or data violating the provisions of the present law or introduces changes to this data after their approval or submission to the Authority.

4. Whoever intently issues incorrect data on the securities regarding securities to which the subscriptions are received by a quarter unauthorized to receive such subscriptions.

5. Whoever forges the Company's registers or intently records in them incorrect data, or submits false data to the General Assembly of the Company.

6. Whoever works to inscribe an untrue price or a simulated transaction, or tries by deception to influence market prices.

7. Whoever registers in the Stock Exchange securities in violation of the provisions of the present law and its executive regulations".

HeinOnline -- 15 Arab L.Q. 30 2000

prospectus, i.e. accountants, lawyers, financial planners and engineers can make them liable under the Capital Markets Law 95 of 1992,[142] Article 63, in addition the judge can apply the Egyptian Penal Law 95 of 1996[143] if the activities of the defendant are not covered under the Capital Markets Law.

The plaintiff's attorney may petition the Egyptian public prosecutor to initiate an action to send his case to a criminal circuit, or the judge of the civil court may refer it to a criminal circuit, if the amount of money involved or if the actions and the scheme of conducting the business have provoked anxiety among many investors as happened in the Al Rayan case in 1990 before the passage of Law 95 of 1992 of the Capital Market. The Egyptian public prosecutor may also initiate action on behalf of many investors who were hurt as a result of misleading statements or false announcements in the form of a true price on a simulated transaction(s), or tries by deception to influence market prices (Article 63 s. 6).[144]

This article advises US law firms that intend to operate in Egypt due to the presence of large US investments in Egypt (estimated to be $2.8 billion)[145] to retain Egyptian law firm services particularly in criminal cases. In describing criminal proceedings in this context, Danner and Bernal argue: "It is not rare to have an experienced Egyptian lawyer speak on his feet for three to four hours without interruption. By doing so, the lawyer tries to coax the facts into a particular mold to trigger the application of a different (and presumably more favorable) provision of the code, or to give rise to a different interpretation of the same article".[146] Although briefs and other written documents are filed with the Egyptian criminal court, Egyptian criminal lawyers show an extreme restraint in this area and do not show the same dedication to the written word as their common law colleagues in the US.[147]

The treatment of the Egyptian Capital Markets Law of liability and misleading statements is very much in line with s. 11 of the Securities Act of 1933. Both Laws have the same simple concept that: "The issuer and a list of statutorily defined potential defendants (including the underwriter and outside experts such as accountants and lawyers) can be held liable if the registration statement, when it became effective, contains a material misrepresentation or omission".[148]

Finally, the Egyptian Capital Markets Law, Article 49, gave the official of the CMA the power and quality (authority) of legal officers "*Al Dabtiah Al Kadahia*".[149] Legal officers of the CMA (like all police officers in Egypt) have

[142] See Danner and Bernal, *supra* note 138, at 5.

[143] The Egyptian Penal Law 95 of 1937 (replaced Law 58 of 1997) states that "Any person who intentionally publishes news, information, rumours, fake or forged papers (or claims it was stated by others), will be subject to imprisonment of not more than one year and a fine not to exceed 20,000 pounds or both, if the aforementioned acts will lead to disturbing the public peace (order), provoking anxieties among people or cause harm to the public interest" (translated from the Arabic version).

[144] See the Capital Markets Law, *supra* note 9, at 24.

[145] See Galal, *supra* note 58, at 8.

[146] See Danner and Bernal, *supra* note 138, at 5.

[147] *Id.*

[148] See Jennings, *supra* note 1, at 882.

[149] See the Capital Markets Law, *supra* note 9, at 24–25.

HeinOnline -- 15 Arab L.Q. 31 2000

the power of collecting and providing evidence of the crimes taking place and occurring in violation of Law 95 of 1992. Toward that purpose, they have the power of access to registers, books, documents and data in the company's head office and quarters, or in the stock exchange centre of the quarter and location where they are to be found.[150] This article argues that the Egyptian criminal procedural and criminal evidence law are applied here, furthermore, the Egyptian public prosecutor may apply the Marshall Law of 1981 which is still in effect, based on instructions from the Egyptian President (who is the Chairman of the Supreme Judiciary Counsel) due to the absence of separation of powers between the judiciary and the executive branches in Egypt.

Due diligence in the US and Egyptian Laws

Due diligence refers to the process that must be complied with prior to an offering being made to the public.[151] The purpose, according to James Arkebauer, is to ensure that the company has complied with all the legal requirements established by the SEC, which includes examining and confirming that the corporate records, financial statements, and background information about the company preparing to go public are honest, correct and in order.[152] Articles 7 and 8 of the Egyptian Capital Markets Law of 1992 and its executive regulations 40, 41, 42, 43, 44, 45 and 46 indicate that the Egyptian legislature has followed the US security laws and jurisprudence as a model law in regard to due diligence. The Egyptian law requires both the company issuing the stock and the underwriter to follow an integrated registration statement. Article 6 of the Egyptian Capital Markets Law gives the CMA rule in facilitating and enforcing a due diligence in the absence of well developed Egyptian underwriters in the transitional economy. (This area is currently developed through the co-operative activities between the SEC and the CMA and Merrill Lynch.) According to Article 6 of Law 95 of 1992, the Capital Markets Law", paragraphs 3 and 4

> The company shall notify the Authority with the balance sheet statement, the financial statements, the reports of the Board of Directors, and the auditor's report thereon, one month before the date scheduled for convening the General Assembly.
>
> The Authority shall examine the documents referred to in the previous clauses, or assign a specialized quarter to carry out this examination. The Authority shall then notify its remarks to the company and require it to reconsider these documents so they should conform to the results of the Examination.[153]

Failure to comply with the aforementioned conditions results in the company having to pay the costs to be incurred by the CMA, when the CMA publishes its

[150] *Id.*
[151] See Arkebauer, *supra* note 89, at 157.
[152] *Id.*
[153] See the Capital Markets Law, *supra* note 9, at 6.

HeinOnline -- 15 Arab L.Q. 32 2000

remarks in two mass distribution morning dailies (newspapers).[154] Publishing the above information by the CMA will definitely give a warning to potential interested investors.

In the Egyptian capital market (as well as in the US capital market) due diligence has proven to be a dynamic concept particularly in the era of information technology which has revolutionised the dissemination and retrieval of information about reporting companies.[155]

Antifraud provisions in the US and Egyptian Laws

Both the US Securities Law (the 1933 Act and the 1934 Act) and the Egyptian Capital Markets Law 95 of 1992 (and its executive regulations) contain antifraud provisions. The 1933 Act contains two anti fraud provisions: s. 12(2) and s. 17(a) and Rule 10B-5 of the 1934 Act applies to the issuance or sale of all securities, even those exempted by the 1933 Act.[156]

Section 12(2) of the US 1933 Act imposes express liability upon any person who offers or sells a security by means of a prospectus or oral communication that contains an untrue statement of material fact or omits a material fact.[157] That liability, according to the prevailing view in US jurisprudence extends only to the immediate purchaser, provided he/she did not know of the untruth or omission.[158] The seller may defend himself/herself from liability by proving that he did not know and in the exercise of reasonable care could not have known of the untrue statement or omission.[159] The seller is liable to the buyer of the security for the amount paid upon tender of the security.[160] If the purchaser no longer owns the security, then he/she may recover damages from the seller.[161]

Section 17(a) of the 1933 Act makes it unlawful for any person in the offer or sale of any securities, whether registered or not, to do any of the following acts when using any means of transportation or communication in interstate commerce or the mails:

1. employ any device, scheme, or artifice to defraud;
2. obtain money or property by means of any untrue statement of a material fact or any statement that omits a material fact, without which the information is misleading; or
3. engage in any transaction, practice, or course of business that operates or would operate as a fraud or deceit upon the purchaser.[162]

The SEC may bring enforcement actions under s. 17(a) Rule 10(b)-5. The 1934 Act makes it unlawful for any person to do any of the aforementioned acts in 1., 2.

[154] *Id.*
[155] See Jennings, *supra* note 1, at 921.
[156] See Mann and Roberts, *supra* note 000, at 1129.
[157] *Id.*
[158] *Id.*
[159] *Id.*
[160] *Id.*
[161] *Id.*
[162] *Id.*

HeinOnline -- 15 Arab L.Q. 33 2000

and 3. in connection with the purchase or sale of any security.[163] Furthermore, Rule 10(b)-5 applies to any purchase or sale of any security whether it is registered under the 1934 Act or not, whether it is publicly traded or closely held, whether it is listed on an exchange or sold over the counter, or whether it is part of an initial issuance or a secondary distribution.[164] The prevailing view in the US jurisprudence, is that the implied liability under Rule 10(b)-5 applies to the purchaser's as well as the seller's misconduct and allows both defrauded sellers and buyers to recover.[165]

Articles 243, 246, and 268 of the executive regulations of the Egyptian Capital Markets Law provide a specific definition of the acts which constitute a fraud or deceit. They state:

Article 243: The company shall be prohibited to follow and apply any methods in its work comprising fraud or deceit, and in particular, the following:

1. Opening fictitious accounts for the purpose of effecting dealings which otherwise cannot be carried out.
2. Carrying out dealings on the client's account, or in his name, without his permission or delegation therefrom, or by exceeding these delegation powers.
3. Spending from the clients' funds on the company's activities, or the activity of any of its directors or workers.
4. Concealing, changing or refraining from stating the substantial facts connected with dealing for securities.
5. Pawning or borrowing, with the guarantee of securities of the clients.

Article 246: The company shall be prohibited to promise in any announcement which will be issued thereby, the realization of any specific financial results when dealing with any of the securities, or to confirm the validity of any expectations, presume the repetition of gains that were previously realized, or suggest anything of that.

Article 268: The company shall not premeditatedly refrain from offering or demanding the securities by sale or buying, for the purpose of moving their prices; nor shall it agree with any party on executing transactions suggesting the existence of offer or demand for these securities.[166]

Much can be said about how the aforementioned Egyptian laws compare to the US law of antifraud. A fundamental difference between the Egyptian laws and the US prohibition against antifraud under 10(b) and Rule 10(b)-5 as developed by the American courts, is that Egyptian laws do not address the issue of the fiduciary duty of the corporate officers to the source of the information for liability to attach, as it will be explained in detail below in the next section under insider trading.

Finally, this article argues that the Egyptian Capital Markets Law does not address the issue of false or misleading facts or omissions made in a proxy statement, notice of meeting, or other communication used in a proxy solicitation. In other words, there is no equivalent to Rule 14(a)-9. proxy fraud in the Egyptian

[163] *Id.*, at 1136.
[164] *Id.*, at 1129.
[165] *Id.*

HeinOnline -- 15 Arab L.Q. 34 2000

Capital Markets Law. Overlooking this issue by the Egyptian legislature may be due to the fact that more than 90 per cent of investors in Egypt are institutional investors and individual investors in Egypt to date play a very minor role in influencing the composition of the Board of Directors of corporations. To date, no such incident has taken place in Egypt under the meaning of Rule 14(a)-9 of the Securities Exchange Act of 1934. This is one area of contention between the Egyptian Government and the US Government, to date Egypt particularly did not pass an anti-corrupt practices law.

The insider trading debate and s. 16(b), s. 10(b) and Rule 10(b)-5 in the USA

The concept of insider trading is rooted in the common law tradition of England, on which the US legal system is based.[167] The US courts played a very important role in developing the law prohibiting insider trading.[168] While Congress gave the mandate for the need to protect investors and keep US markets free from fraud, it has been the jurists who have played the largest role in defining the law of insider trading.[169]

After the US stock market crash of 1929, Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934, aimed at controlling the abuses believed to have contributed to the crash. The 1934 Act addressed insider trading directly through s. 16(b) and indirectly through s. 10(b).[170]

Section 16(b) prohibits profits realised in any period less than six months (short-swing profits) by corporate insiders in their own corporation's stock, except in very limited circumstances. Section 16(b) applies only to directors or officers of the corporation and those holding greater than 10 per cent of the stock and is developed to prevent insider trading by those most likely to have access to important corporate information.[171]

Section 10(b) of the Securities and Exchange Act of 1934 makes it unlawful for any person Ato use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the (SEC) may prescribe". To enforce s. 10(b)-5, which provides, in relevant part:

> It shall be unlawful for any person, directly or indirectly, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made not misleading, or (c) to engage in any act, practice, or course

[166] See the executive regulations of the Capital Markets Law, *supra* note 133, at 110 and 118.
[167] See Remarks by Thomas C. Newkirk and Melissa A. Robertson in The 16th Annual Symposium on Economic Crime, Cambridge, England (http://www.sec.gov/news/speeches/spch221.htm).
[168] See Newkirk and Robertson, *supra* note 167, at 3.
[169] *Id.*
[170] *Id.*
[171] *Id.*, at 4.

HeinOnline -- 15 Arab L.Q. 35 2000

of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of a security.[172]

The above broad antifraud provisions, make it unlawful to engage in fraud or misrepresentation in connection with the purchase or sale of a security.[173] While the aforementioned (a), (b) and (c) of Rule 10(b)-5 do not expressly mention insider trading, the US courts have made law which led to the most important developments in insider trading law in the USA (and abroad with the countries who have bilateral securities agreements with the USA).

The antifraud provisions of Rule 10(b)-5 were relatively easy to apply to the corporate insider (i.e. officers, directors) but for outsiders, the same rule seems to be less clear.[174] In 1961, in the case of *In re Cody Roberts & Co.*, the SEC, applying a broad interpretation of the provisions, held that they do.[175] The SEC argued that the duty or obligations of the corporate insider could attach to those outside the insiders circle in certain circumstances. The Commission's reasoning was as follows:

> Analytically, the obligation [not to engage in insider trading] rests on two principal elements: first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing. In considering these elements under the broad language of the anti-fraud provisions, we are not to be circumscribed by fine distinctions and rigid classifications. Thus, it is our task here to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading its securities. Intimacy demands restraint lest the uninformed be exploited.[176]

Based on the aforementioned reasoning, the Commission ruled that a broker who traded while in possession of non-public information he received from a company director violated Rule 10(b)-5.

Melissa A. Robertson and Thomas C. Newkirk of the SEC argued at the sixteenth International Symposium on Economic Crime in England in September 1998, that the SEC adopted the "disclose or abstain rule". Insiders, and those who would come to be known as "temporary" or "constructive" insiders, who possess material non-public information, must disclose it before trading or abstain from trading until the information is publicly disseminated.[177] Several years later, Robertson points out, in the case of *SEC* v. *Texas Gulf Sulphur Co.*, a federal circuit court supported the Commission's ruling in *Cody*, reasoning that anyone in possession of insider information is required either to

[172] *Id.*
[173] *Id.*
[174] *Id.*
[175] *Id.*
[176] *Id.*
[177] See Newkirk and Robertson, *supra* note 167, at 5.

HeinOnline -- 15 Arab L.Q. 36 2000

disclose the information publicly or refrain from trading.[178] The court ruling is based on the view that "no one should be allowed to trade with the benefit of inside information because it operates as a fraud to all other buyers and sellers in the market".[179]

The 1980s decade witnessed corporate takeovers and mergers in the US which involved raising large amounts of money.[180] During this period, the practice of insider trading reached new heights.[181] Ironically, Robertson argues, it is during this period that US courts narrowed the scope of s. 10(b) and Rule 10(b)-5 in the insider trading context.[182] In the 1980 case of *Chiarella* v. *United States*, the US Supreme Court reversed the criminal conviction of a financial printer who gleaned non-public information regarding tender offers and a merger from documents he was hired to print and bought stock in the target of the companies that hired him.[183]

[178] *Id.*
[179] *Id.*
[180] *Id.*
[181] *Id.*
[182] *Id.*
[183] *Id.* (arguing that the case was tried on the theory that the printer defrauded the persons who sold stock in the target to him. In reversing the conviction, the Supreme Court held that trading on material nonpublic information in itself was not enough to trigger liability under the antifraud provisions and because the printer owed target shareholders no duty, he did not defraud them. In what would prove to be a prophetic dissent, Berger C.J. opined that he would have upheld the conviction on the grounds that the defendant had "misappropriated" confidential information obtained from his employer and wrongfully used it for personal gain.

In response to the *Chiarella* decision, the Securities and Exchange Commission promulgated Rule 14(e)-3 under Section 14(e) of the Exchange Act, and made it illegal for anyone to trade on the basis of material non-public information regarding tender offers if they knew the information emanated from an insider. The purpose of the rule was to remove the *Chiarella* duty requirement in the tender offer context – where insider trading was most attractive and especially disruptive.

In 1981, the Second Circuit adopted the "misappropriation" theory, holding in the case of *United States* v. *Newman* that a person with no fiduciary relationship to an issuer nonetheless may be liable under Rule 10(b)-5 for trading in the securities of an issuer while in possession of information obtained in violation of a relationship of trust and confidence. Newman, a securities trader, traded based on material non-public information about corporate takeovers that he obtained from two investment bankers, who had misappropriated the information from their employers.

Three years later in *Dirks* v. *SEC*, the Supreme Court reversed the SEC's censure of a securities analyst who told his clients about the alleged fraud of an issuer he had learned from the inside before he made the facts public. *Dirks* was significant because it addressed the issue of trading liability of "tippees", those who receive information from the insider tipper. *Dirks* held that tippees are liable if they knew or had reason to believe that the tipper had breached a fiduciary duty in disclosing the confidential information and the tipper received a direct or indirect personal benefit from the disclosure. Because the original tipper in *Dirks* disclosed the information for the purpose of exposing a fraud and not for personal gain, his tippee escaped liability.

A significant aspect of the decision was contained in a footnote to the opinion, which has come to be known as "*Dirks* footnote 14". There, Powell J. formulated the concept of the "constructive insiders" – outside lawyers, consultants, investment bankers or others – who legitimately receive confidential information from a corporation in the course of providing services to the corporation. These constructive insiders acquire the fiduciary duties of the true insider, providing the corporation expected the constructive insider to keep the information confidential.

The Second Circuit again addressed the misappropriation theory in the 1986 case of *United States* v.

HeinOnline -- 15 Arab L.Q. 37 2000

After almost 15 years of court debate on the suitability of the *misappropriation* theory as a basis of conviction of outsiders who have access to non public information, in 1997 in a landmark victory for the SEC, the Supreme Court reversed its previous decisions and explicitly adopted the misappropriation theory of insider trading in the case of *United States* v. *O'Hagan*.[184]

contd.
Carpenter. The case centered on a columnist for *The Wall Street Journal*, whose influential columns often affected the stock prices of companies about which he wrote. The columnist tipped information about his upcoming columns to a broker (among others) and shared in the profits the broker made by trading in advance of publication. In upholding the convictions of the columnist and the broker for securities fraud under Rule 10(b)-5 and mail and wire fraud, the Second Circuit rejected the defendants' argument that the misappropriation theory only applies when the information is misappropriated by corporate or constructive insiders, holding "[T]he misappropriation theory more broadly proscribes the conversion by insiders' or others of material non-public information in connection with the purchase or sale of securities".

The case was appealed to the Supreme Court. The Supreme Court unanimously agreed that Carpenter engaged in fraud. But in unanimously affirming the mail and wire convictions, the Court quoted an earlier New York decision that ruled: "It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principal for any profits derived therefrom".

Over the next nine years, the misappropriation theory gained acceptance in federal courts. Then in 1995 and 1996, two federal circuit courts rejected the misappropriation theory on the grounds that the theory "requires neither misrepresentation nor nondisclosure" and that "the misappropriation theory is not moored [in] [section] 10(b)'s requirement that the fraud be "in connection with the purchase or sale of any security".

[184] See Newkirk and Robertson, *supra* note 167, at 6. O'Hagan was a partner in a law firm retained to represent a corporation, Grand Met, in a potential tender offer for the common stock of the Pillsbury Company. When O'Hagan learned of the potential deal, he began acquiring options in Pillsbury stock, which he sold after the tender offer for a profit of over $4 million. O'Hagan argued, essentially, that because neither he nor his firm owed any fiduciary duty to Pillsbury, he did not commit fraud by purchasing Pillsbury stock on the basis of material, non-public information.

The court rejected O'Hagan's arguments and upheld his conviction. The court held, significantly, that O'Hagan committed fraud in connection with his purchase of Pillsbury options, thus violating Rule 10(b)-5, based on the misappropriation theory. In the court's view:

The "misappropriation theory" holds that a person commits fraud "in connection with" a securities transaction, and thereby violates 10(b) and Rule 10(b)-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of the information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.

In the course of its opinion, the court identified two discrete arguments for prohibiting insider trading. First, the court stressed that prohibiting insider trading is:

"... well-tuned to an animating purpose of the Exchange Act: to ensure honest securities markets and thereby promote investor confidence. Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated non-public information is unchecked by law. An investor's informational disadvantage *vis-à-vis* a misappropriator with material, non-public information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill".

Second, the court acknowledged the "information as property" rationale underlying insider trading prohibitions: "A company's confidential information ... qualifies as property to which the company has

HeinOnline -- 15 Arab L.Q. 38 2000

Insider trading in Egypt, Articles 231, 232, 233, 234, 235, 236, 237, 240, 242 and 244 of the Egyptian "Capital Markets Law"

As US law makers, courts and regulators struggled to refine prohibitions on insider trading, Egypt and the rest of the world markets, with few exceptions, went virtually unregulated prior to the 1980s in Europe and 1992 in Egypt.[185] Articles 231 and 244 of the Egyptian executive regulations of the Egyptian Capital Markets Law defines "inside information" as information of a "general and precise nature" about security on issues which has not been made public which, if it were made public, "would likely have a significant effect on the price of the securities".[186] Article 231 states the general nature of activities:

> In its dealings with its clients, the company shall adhere to the principles of honesty, attention to their interests, and equality between those having a similar nature and situations of their dealings with the company. It shall avoid whatever is likely to offer privileges, bonuses and incentives, or special information to some of them without the rest, whether directly or indirectly. It shall not perform any work liable to cause harm to any of them.[187]

The Egyptian legislature did not explicitly use the term insider trading, but it did describe activities which are not in conformity with principles of honesty. This article argues that this approach is a wise approach, since the culture and practices of the Egyptian *Bourseh* (Stock Exchange) during foreign domination (prior to the revolution of 1952) by the Italians and Greeks viewed insider trading as an acceptable practice. The Egyptian legislature appeals to the principles of honesty which is very much drawn from Islamic law and jurisprudence that is, *Ausyul Al Fugh*. It is breaking away from the old traditions of the Egyptian capital market which was dominated by the Italians and Greeks whose interests were protected by a special branch of the judiciary (the Mixed Courts). This was a court system that had operated in Egypt from 1876 until 1949. It had jurisdiction in civil and commercial cases in which a foreign interest was involved; also, it was given limited criminal jurisdiction.[188] While only a minority of judges were Egyptian (i.e. Egyptians of Ottoman Empire Citizenship) in the years from establishment in 1875, and full operation in 1876, Egyptians were a majority by 1949. Brown considered the system was a direct challenge to Egyptian sovereignty along with

contd.
a right of exclusive use. The undisclosed misappropriation of such information in violation of a fiduciary duty ... constitutes fraud akin to embezzlement – the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another".

Although the law of insider trading in the US is continuing to evolve, the decision in *O'Hagan* is a significant milestone in defining the scope of Rule 10(b)-5 insider trading prohibitions.

[185] See Brown, *supra* note 91, at 34.
[186] See the executive regulations of the Capital Markets Law, *supra* note 133, at 106 and 110.
[187] *Id.*
[188] See Brown, *supra* note 91, at 39.

HeinOnline -- 15 Arab L.Q. 39 2000

the capitulations system started in 1882.[189] Dr Mark Hoyle's research on the impact of the Mixed Courts in Egypt indicates, however, that the Mixed Courts liberated much of the litigation from capricious consuls such as those of Italy and Greece, who had a notorious habit of finding for their nationals in cases brought in the consular courts, and substituted a more merit based result.[190]

Article 244 addressed in a more precise or concrete way insider trading. It states:

> Neither the company nor any of its directors or workers shall deal for the securities in respect of which it has obtained information or data which are unannounced in the market or unavailable to the rest of the dealing clients, even if these data or information was incomplete, and whether they are connected with an imminent dealing for these securities or with another order having a substantial effect on the securities or the quarters issuing them, or the prices of dealing in them.[191]

The aforementioned article does not make a differentiation between information obtained from outside sources or inside sources. One may argue that the fundamental difference between Egyptian laws and the US' prohibition against insider trading under s. 10(b) and Rule 10(b)-5 as developed by the courts, is that the Egyptian Articles 231 and 244 does not require that the insider trader breach a fiduciary duty to the sources of information for liability to attach.[192] In this respect, this article argues, the aforementioned articles (231 and 244 of the executive regulations of the Capital Markets Law, mirrors the US' prohibition against trading on the basis of non-public information about a tender offer under s. 14(e) of the Securities Exchange Act of 1934 and the Commission's Rule 14(e)-3, where the Supreme Court recently upheld this Rule in *United States* v. *O'Hagan*.[193]

Another area which definitely shows that the Egyptian Capital Markets Law is not exactly modelled on the US Securities Laws is that Egypt does not have laws

[189] *Id.* (explaining that the Mixed Courts represented a particularly complex issue for the occupation because of their international nature and close connection with many aspects of Egyptian government and finances. In the early years of the occupation, the British seemed uncertain as to their purpose in Egypt. The problem was that they had two contradictory commitments; to restore the khedival government and sound finances to the country and to leave it as soon as circumstances warranted. The capitulations blocked both paths. On the one hand, if the British left Egypt with the capitulations intact, the sort of fiscal and political crisis that led to the occupation might recur. On the other hand, were the British to remain in Egypt, capitulatory privileges would obstruct their control of Egyptian affairs. Already during the first year of the occupation, Lord Dufferin complained, "Every day my attention has been attracted by the absolute impossibility of even the most necessary police regulations being carried into effect in consequence of the impotence to which the Egyptian police officials are reduced by the capitulations, and the facilities afforded to foreigners to escape from the consequences of their illegal acts". The capitulations were an obstacle to reforms that went beyond the suppression of crime. The British sought changes in the state budget, taxation, justice, and a whole host of administrative matters. Such changes inevitably affected foreigners and thus came within the jurisdiction of the Mixed Courts. Indeed, in 1887, the Mixed Court of Appeal ruled that the Egyptian Government had no authority to change the codes of the Mixed Courts unilaterally, guaranteeing each capitulatory power the right of veto over legislation.

[190] See Hoyle, *Mixed Courts of Egypt*, Graham & Trotman, London/Dordrecht/Boston, 1991, pp. 6–11, 12–30, and 31–40 generally.

[191] See the executive regulations of the Capital Markets Law, *supra* note 167, at 8.

[192] See Newkirk and Robertson, *supra* note 167, at 8.

[193] *Id.*

HeinOnline -- 15 Arab L.Q. 40 2000

prohibiting monopolies, cartels, or conflict of interest.[194] In fact, Article 235 of the executive regulations of the Egyptian Capital Markets Law acknowledges explicitly the possible presence of interlocking directorships between two companies who are working in the securities industry. Article 235 states:

> The stockholders, directors and workers of the company, in managing or participating in the management of another company operating in the same fields of activities of the companies which are subject to the provisions of this part, shall observe separating completely between the activity of each of the two companies, in the dealings, thereby realizing total independence of each company, in a way that does not lead to the emergence of incompatibility of interests between the two companies or between either one and the dealers with the other company.[195]

This article argues that this is a naive approach of the Egyptian legislature to a serious area which is likely to lead to the possible leak of information from insider to another insider of the interlocking directorship. Furthermore, the Presidential power or the "power of the Presidency" in Egypt as a political institution far exceeds the Presidential power of the US system or any Western democracy. The President in Egypt appoints the presidents and members of the boards of large institutions, such as banks and large publicly held corporations if the Government has a large share in its stocks. Hence, the individual shareholders who usually constitute the minority have really no power in the appointment of board members. Furthermore, majority investors in Egypt like in Germany and Japan are mostly institutional investors, i.e. pension funds, insurance companies, banks or local government authorities and municipalities. Their board of directors members usually serve in each other's boards under the notion of co-ordinating their activities (the activities of these institutions). This, of course, is open to corrupt practices which are usually hard to detect in the absence of freedom of the press and effective control mechanisms. Antitrust is one of the areas in which currently US negotiators are working to overcome the differences with their Egyptian counterparts in negotiating the proposed free trade agreement between Egypt and the USA. It is too soon, however, to make any intelligent generalisations about the effectiveness of the current Egyptian Capital Markets Law."

In the scheme of things, insider trading laws in Egypt's transitional economy are in their infancy, but the Egyptian Government's desire to bring the Cairo Stock Exchange into line with world standards would make the CMA work hard to police insider trading. Furthermore, Egypt's desire to attract foreign investors particularly from the USA, is likely to make sincere efforts to boost the confidence of US investors, by, for instance, agreeing on reciprocal extraterritorial applications of US Securities Laws in Egypt and Egypt's Capital Markets Law in the US.

[194] See Galal, *supra* note 58, at 76.
[195] See the executive regulations of the Capital Markets Law, *supra* note 133, at 107.

HeinOnline -- 15 Arab L.Q. 41 2000

COSTS AND BENEFITS FOR US INVOLVEMENT IN THE EGYPTIAN CAPITAL MARKET

Forces of globalisation

Securities markets around the world have become increasingly global as US investors have expanded their holdings of foreign securities and foreign issuers have made greater use of the US capital markets.[196] In 1980, US investors bought or sold only an estimated $17.9 billion in foreign bought $914.6 billion in US securities in 1995.[197] The literature on the internationalisation of securities markets provided the following explanation:

> Driving the movement to a globalized securities market is a variety of factors: (1) capital market imbalances caused by national differences in saving rates and investment opportunities with the result that some nations (the OPEC countries early in the 1980s and Japan later in the decade) became the world's supplier of capital; (2) the development of new technology for international trading, e.g. satellite communications, computer advances and fiber optics; (3) the desire of institutional investors to hold an internationally diversified portfolio of securities to reduce their exposure to economic downturn in any one country; (4) the need of issuers to tap international equity markets to reduce their cost of capital; and (5) the fear of the United States financial services industry that unless foreign issuers were accommodated, the United States dealers would be excluded from profitable business and foreign securities markets would gradually outdistance American markets in terms of their depth and liquidity.
>
> The internationalization of securities markets carries profound implications for the world's securities market regulators. Although the gains to both issuers and investors from reducing the barriers to transnational capital flows seem obvious, so also are the risks. For example, when 24 hour trading in US securities eventually develops and corporations list their stock on stock exchanges in New York, London and Tokyo, offshore trading (particularly in securities of United States corporations, might provide a haven for insider trading or other manipulative practices that would quickly be detected and prosecuted within the United States. Yet, what is the extraterritorial reach of the United States securities laws?[198]

The above realities of the internationalisation of the securities markets needs more co-operation among international enforcement authorities.

The political and economic dimensions of US–Egyptian relations

Benjamin A. Gilman, the Chairman of the US House of Representatives' Committee on International Relations of the 105th Congress, has described US–Egyptian relations as a key element in American policy in the Middle East since the 1970s.[199] He contends that the two nations have been united since the 70s in order

[196] See Jennings, *supra* note 1, at 1614.
[197] *Id.*
[198] *Id.*
[199] U.S. Policy Toward Egypt – Hearings in H.R. before the Committee on International Relations, 105th Congress (1997) (Statement of Benjamin A. Gilman, Chairman of the Committee).

HeinOnline -- 15 Arab L.Q. 42 2000

to pursue several common strategic goals of promoting regional peace and stability and the opposition to international terrorism and the spread of Islamic extremism in the region. He further delineated the scope and intensity of the bilateral relationship between Egypt and the US in the 10 April 1997 Congressional hearing dealing with US policy toward Egypt by arguing that:

> Our US–Egyptian bilateral relationship is marked by a significant level of military cooperation, including joint military exercises, a large scale aid and development program, frequent high level meetings between our political leaders, and a generally shared perception of the complexities in trying to maintain regional stability. Without question, Egypt has in the past played an indispensable role in shaping the environment for peace. Egypt pointed the way to Arab reconciliation with Israel in the 1979 Camp David Accords.[200]

In describing the geopolitical importance of Egypt to Israel and its long term survival in a region so hostile to its existence, Robert Satloff, the executive director of the Washington Institute for Near East Policy, argues at the same aforementioned Congressional hearing that: "Egypt's importance is self evident. For two decades, this relationship has been a centerpiece of US policy, a centerpiece of US efforts to bolster peace and security in the Middle East".[201]

In the span of ten years, from the 1979 Camp David Accords to 1989 (when diplomatic relations were restored between Egypt and the other Arab states) more than five million Egyptian citizens working in the other Arab countries were the target of public scorn and humiliation. Egyptian professors, who staffed the high ranks of Saudi, Kuwaiti, Libyan, Iraqi and Algerian universities were publicly called traitors of the Arab cause. Egyptian physicians and scientists were leading a new Arab renaissance resulting from the influx of oil revenues after the oil embargo of 1973, were kicked out of their jobs or had their salaries drastically reduced. These highly educated and skilled Egyptians, although they were mistreated, were more fortunate than the Egyptian blue collar workers who were employed in the construction industry in the Arab oil producing countries. Their native sponsors took advantage of the situation by requiring longer working hours of the Egyptian workers for less pay. Egyptian supervisors in the construction industry were replaced by other nationalities and in some cases fired without the ability to collect their back wages. Arab courts and lawyers refused to represent them in any lawsuit to recover their wages. In the absence of complete diplomatic representation between Egypt and these Arab countries, more than five million Egyptian professionals and blue collar workers were destitute, injured and had their personal safety and security compromised. Due to the bad economic situation back home in Egypt, they had no choice but to continue their miserable lives, powerless and helpless, outside of their homeland.

The potential argument in favour of closer economic ties between Egypt and the USA, is made by Robert Z. Lawrence and Ahmed Galal who argue that the

[200] *Id.*

[201] U.S. Policy Toward Egypt – Hearings in H.R. before the Committee on International Relations, 105th Congress 3 (1997) (Statement of Robert Statloff, Executive Director of the Washington Institute for Near East Policy).

HeinOnline -- 15 Arab L.Q. 43 2000

political case rests on the crucial role Egypt plays for the US in helping to achieve peace and maintain a stable supply of oil in the Middle East.[202] Also, Egypt is receiving an equivalent of 2.3 billion US dollars a year which includes $1.3 billion to purchase US military equipment which provides at least 10,000 jobs for US workers in the US military industrial complex[203]; and 850 million US dollars worth of technical assistance projects in Egypt in the areas of agricultural development, judicial reforms, telecommunications, sanitary and fiscal reforms and micro enterprise development.[204] These technical assistance projects are implemented exclusively by US contractors who hire at least 30,000 American international development specialists, and finally commodity support programs which would enable US exports to compete effectively with European and Japanese competitors for Egyptian procurement.[205] This is likely to generate approximately 25,000 jobs in the USA according to an assessment by the US Chamber of Commerce in Cairo.

The economic argument is based on compelling evidence that US investment in the Egyptian capital market would enhance welfare and economic growth in Egypt. The US could help promote Egyptian economic reform and growth of its capital market, through the creation of liquidity.[206] Another important development took place which makes closer ties between the US and Egypt necessary. Egypt has already signed a Free Trade Agreement ("FTA") with the Arab countries and has taken major steps toward signing a FTA with the European Union.[207] When these agreements are implemented and their competitors begin to enjoy duty-free access to Egypt, American investors and/or US MNC export will be increasingly at a disadvantage in the Egyptian Market.[208] According to a recent study, Robert Z. Lawrence and Ahmed Galal reported that major trading partners with Egypt, such as the US, are likely to respond by demanding that Egypt open its markets to them.[209] Howard L. Stovall describes in his article entitled, "Some Current Legal Issues Concerning Trade and Investment in Egypt", the competition of the Japanese, British and the French Governments and their private investors on the potentially attractive Egyptian capital market, Egypt population estimated at 60 million with total imports estimated to be at least $9 billion (US) annually.[210]

For US MNC's and direct investors, Egypt (and its capital markets) is a good business opportunity. In contrast to some of the other jurisdictions in the Middle East, the present Egyptian legal framework of laws, regulations and court decisions provide a relatively well developed and accessible jurisprudence and therefore, a

[202] See Galal, *supra* note 58, at 2.
[203] *Id.*, at 8.
[204] See Galal, *supra* note 58, at 2.
[205] *Id.*
[206] *Id.*
[207] *Id.*, at 3.
[208] *Id.*
[209] See Galal, *supra* note 58, at 2.
[210] See Stovall, *supra* note 80, at 124.

HeinOnline -- 15 Arab L.Q. 44 2000

relatively more "certain" legal environment for US direct investors planning commercial arrangements.[211]

Finally, in that respect, the following observations of the American Chamber of Commerce in Cairo, Egypt, reinforces the aforementioned evidence of the potentiality of the Egyptian Capital Market for US investors:

> Privatization in Egypt is taking two forms: divestment of public sector holdings in production and manufacturing companies; and encouragement of private sector investment in sectors historically controlled and operated by the public sector, such as electricity, roads, airports, ports, and oil and gas transmission. With respect to the capital market, the May 22 decision of the cabinet to repeal the 2% capital gains tax on the sales of shares and to exempt mutual funds from a 40% income tax has resulted in an increase in activity. In addition, a new clearing and settlement system is due to come into operation shortly to ensure clearing and settlement of "transaction plus 3 days" instead of the current physical delivery system, which takes up to 10 days. Concerning investment in the banking sector, the government has approved a statutory amendment to permit majority foreign equity ownership in locally-registered banks.
>
> Egypt is a member of the World Trade Organization, enjoys Most Favored Nation status with the United States, has a preferential trade accord with the European Union, and is a signatory on bilateral investment agreements and double tax treaties with a large number of nations. Egypt and the US have an investment guarantee agreement through the Overseas Private Investment Corporation and a Bilateral Investment Treaty (1992) that ensures non-discrimination for investors of the two countries and sets legal standards with respect to expropriation, compensation, and international arbitration of investment disputes. The "Partnership for Economic Growth and Development", a bilateral Egyptian-US program begun in March 1995, is also designed to stimulate private sector investment through "quick start" projects in the area of technology transfer, development of Upper Egypt, and eco-tourism in Sinai, the Red Sea, and Upper Egypt.[212]

CONCLUSION

This article concludes that the US securities laws and regulations are suitable to serve as a model law for the relatively newly regulated Egyptian capital market, despite the differences of the origins of the two legal systems. The close political and economic ties between the USA and Egypt, embodied in the Bilateral Investment Treaty of 1992, the partnership for Economic Growth and Development of March 1995, and the February 1996 agreement between the US SEC and the Egyptian CMA for technical assistance, information exchange and co-operation of enforcement, can serve as a springboard to advance the two nations' interests.

The forces of globalisation and the development of the telecommunication technologies have led to the internationalisation and integration and yet

[211] *Id.*, at 125.
[212] See American Chamber of Commerce in Egypt, *supra* note 79, at 2.

HeinOnline -- 15 Arab L.Q. 45 2000

vulnerability of the securities markets all over the world. The common law, civil law and Islamic law are evolving towards hybrid systems that borrow elements from one another.

For many Americans, the idea of a free trade agreement between the US and Egypt as a springboard for US direct investment in the Egyptian capital market by large, medium and small size enterprises or individual investors in Egyptian development projects may be surprising. As Egypt is seen as a low income country, a recipient of US aid rather than an opportunity for trade.[213] This article argues that the fact is that Egypt is an opportunity for US investment in the capital market and US exports. According to a recent market study by US commercial specialists in Cairo, reported by the *Middle East Executive Reports* (December 1977), Egyptian imports of environmental technologies are expected to reach $774 million in 1998, compared with $704 million in 1997 and $740 million in 1996.[214] Egypt's population problem (60 million) can be a marketing opportunity for US firms.[215] The signing of an agreement with IMF in 1991 and Paris Club forgiveness of 50 per cent of Egypt's official debt obligations and the April 1997 announcement of the IFC that it will establish a risk management facility (RMF) with a value of $400 million for the largest bank in Egypt (National Bank of Egypt)[216] are positive indicators of a growing economy, which will spawn the need for a variety of goods and services, many of which are currently not widely available.[217] Examples are computers and industrial equipment that can help increase the nation's productivity. The increased productivity, in particular, will help Egypt improve the standard of living of its people as well as provide the basis for developing an export economy that can help the country grow and pay for its international purchases particularly from the USA. Cairo's National Bank of Egypt has recently acquired New York based Arab American Bank which has assets of $594 million.[218] This is a positive indicator of the seriousness of the Egyptian business community to expand into the USA capital market, which will lead to a stronger Egyptian presence to the "mutual benefit for Egypt and America which will attract new business between us" said Mohamad Abdul Aziz, the Chairman of Egypt's Bank in New York.

Finally, this article concludes with the following reform proposals:

(1) The US investors in the Egyptian capital market should not look to Islamic banking in Egypt as a threat. The fact is that Islamic banks in Egypt are business opportunities. They are in need of US technical assistance in the areas of custodial, clearing and settlement systems for their security instruments. Improved efficiency in these systems would reduce not only transaction costs but also certain types of risks;

[213] See Galal, *et al.*, *supra* 58 at 37.
[214] *Id.*, at 38.
[215] The Arab World Online, *supra* note 10 at 13.
[216] *Id.*
[217] *Id.*, at 1.
[218] The Arab World Online, *supra* note 10, at 1.

HeinOnline -- 15 Arab L.Q. 46 2000

(2) The continued and accelerated privatisation of Egyptian public enterprises would assist in the development of capital markets in two possible ways. First, it would increase the supply of tradeable shares on the exchanges – the book value of the public enterprises are estimated to account for XX per cent of existing market capitalisation. Second, privatisation provides a clear and strong signal of the Egyptian Government's commitment to market reforms;[219]

(3) Finally, Egyptian CMA regulators and legal officers should benefit from the current collaborative arrangements with the SEC through the SEC's technical assistance program to sharpen their knowledge about initial public offering (IPO), promoting investor confidence and developing regulatory structures suitable to the complicated realities of the Egyptian capital markets. These activities will lead to the establishment of international standards for accounting and auditing which would provide the basis for reliable financial information in the Egyptian capital market.

[219] See World Bank Report No. 1607–EGT, *supra* note 21, at Volume III 67.

HeinOnline -- 15 Arab L.Q. 47 2000