Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—U.S.: Solicitor General urges justices to decline 'Morrison' case involving unsponsored ADRs, (May 21, 2019)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

For the second time in just days the Solicitor General has recommended that the Supreme Court not hear a securities case, this time urging the justices to sidestep the question of whether unsponsored ADR transactions in the U.S. were sufficiently domestic under *Morrison*.

The October 2018 Supreme Court term will end in June with the justices having decided just one securities case (*Lorenzo*), a break from recent years in which the justices typically mulled two or three securities cases each term. It remains possible, however, that the justices could decide to hear one or more securities cases whose certiorari petitions are still pending before the court during its 2019 term, including a case involving Toshiba Corporation whose American Depositary Receipts (ADRs) were the subject of domestic transactions in the U.S. Still, the odds of a grant in the *Toshiba* case are likely more remote now that the Solicitor General has recommended against taking the case. Several days ago, the Solicitor General also recommended that the justices decline to hear another securities fraud case (*First Solar*—question regarding loss causation). Moreover, the government's recommendations come on the heels of the Supreme Court's own decision to dismiss a case in which it had already heard oral argument (*Emulex*—involving Exchange Act Section 14(e)) (Toshiba Corporation v. Automotive Industries Pension Trust Fund, May 20, 2019).

Prelude to a cert. petition. The plaintiffs (respondents before the Supreme Court) in the *Toshiba* case were U.S. investors who bought unsponsored Toshiba ADRs in the U.S. Upon learning that Toshiba had admitted financial irregularities, the plaintiffs sued Toshiba alleging fraud under Exchange Act Section 10(b) on the basis of their ADR purchases. The District Court dismissed the case with prejudice because *Morrison*'s requirements regarding the extraterritorial application of U.S. securities laws precluded the suit. The Ninth Circuit reversed and remanded because, in its view, *Morrison* did not preclude the suit, but the district court must still rule on the adequacy of the plaintiffs' complaint.

In its petition for certiorari, Toshiba put the question thus: "…is a domestic transaction necessary and sufficient for application of the Exchange Act, or is a domestic transaction necessary but, by itself, not sufficient for application of the Act?" (in its amicus brief responding to the justices' invitation to present the government's views, the Solicitor General rephrased the question presented to eliminate the "necessary but, by itself, not sufficient" language used by Toshiba). Toshiba emphasized that the Second Circuit's decision in *Parkcentral*, which would be persuasive but not binding in the Ninth Circuit, provided a basis for overturning the Ninth Circuit's decision to let the plaintiffs amend their complaint against Toshiba.

Specifically, Toshiba asserted that the facts, as filtered through *Morrison* and *Parkcentral*, would result in an impermissible extraterritorial application of the federal securities laws. Toshiba stated that the pension funds' claims involve a domestic transaction to which Toshiba was not a party, that the domestic transaction that did occur involved references to securities traded overseas only, that the cited fraudulent statements were made overseas regarding an overseas company whose shares trade on a foreign exchange, and that foreign investigators had reviewed the allegations against Toshiba.

Toshiba also cited various additional reasons for the justices to hear the case. For one, Toshiba noted the "express circuit split" between the Second and Ninth Circuits. The company also observed that these circuits have the highest concentrations of securities class actions, a fact that gives them a "preeminent role" in resolving

the attendant legal questions. Moreover, Toshiba said it was concerned that leaving the Ninth Circuit decision in place will encourage forum shopping that could result in an overseas firm being held liable for securities violations in American courts solely because a third party imported the firms' securities into the U.S. Toshiba also asserted that the Ninth Circuit decision would upset international comity among the world's securities regulators.

Ninth Circuit got it right. According to the government, the Ninth Circuit correctly held that *Morrison* would not preclude the plaintiffs' suit against Toshiba, although the Ninth Circuit's decision to remand was likewise appropriate so the district court could address the sufficiency of the complaint (i.e., did the plaintiffs allege fraud "in connection with" Toshiba's unsponsored ADRs). The government also noted that it was undisputed that the transactions at issue were domestic transactions.

The government further observed that, as the Ninth Circuit had mentioned, Toshiba appeared to "conflate" the separate questions of whether Exchange Act Section 10(b) applies and whether that provision had been violated. The government said *Morrison* rejected the notion that a defendant company's connection to the transactions is relevant (the government explained that the Supreme Court in *Morrison* emphasized the domestic nature of the transaction, not the company's conduct).

Moreover, the government urged the justices to reject Toshiba's theory about the applicability of the Second Circuit's Parkcentral decision, which the government said could revive the conduct-and-effects test that was discredited in *Morrison*. The government also noted that the invocation of *Parkcentral* now would contradict post-*Morrison* legislative changes to the securities laws which permit the SEC and the DOJ to rely on the conduct-and-effects test, but not private litigants.

Lastly, the government observed that although the arguments posited by Toshiba may be unavailing in the *Morrison* context, those same arguments could help the company persuade the district court that the plaintiffs failed to allege that Toshiba's admitted financial fraud was "in connection with" the purchase of Toshiba ADRs in the U.S. Here, the government noted the distinction between sponsored and unsponsored ADRs and suggested that the latter type possibly gives Toshiba a degree of distance from the U.S. transactions in unsponsored ADRs (Toshiba's certiorari petition had argued that the company did not sanction the U.S. ADRs and its securities traded outside the U.S.). The government, without taking a position, also suggested that materiality, scienter, reliance, and loss causation may be problematic for the plaintiffs and that the totality of the elements of a securities fraud suit could function to limit the impact of the case, however it is eventually resolved.

Three more reasons to decline case. The government tacked on three additional reasons for the justices to decline the case. For one, the case is interlocutory in nature because both lower courts held the complaint was insufficient, although the Ninth Circuit would permit the plaintiffs to amend the complaint. The government said this procedural posture means the only question the justices could decide is whether leave to amend would be futile and not the substantive *Morrison* question or other questions about the adequacy of the pleadings.

Second, the government said that while there is "tension" between the Ninth Circuit's opinion in *Toshiba* and the Second Circuit's *Parkcentral* opinion, there is "no square conflict." The government even noted that *Parkcentral*'s fate was potentially uncertain given the Supreme Court's later clarification of *Morrison* and several more recent Second Circuit opinions that either do not cite *Parkcentral* or cite *Parkcentral* while finding a domestic claim.

Third, the government said the application of *Morrison* to the Toshiba ADR transactions in the U.S. was "straightforward" and that the international comity worries expressed by Toshiba were likely overblown. The government here also analogized to its prior observation about whether the plaintiffs could meet the "in connection with" requirement of the securities laws (i.e., Toshiba may, for a variety of reasons, be too distant from the U.S. transactions to be held liable) and further suggested that Toshiba may be able to show that U.S. courts lack specific personal jurisdiction (i.e., minimum contacts) or general jurisdiction (i.e., continuous and systematic contacts) over Toshiba.

The case is No. 18-486.

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Companies: Toshiba Corporation

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