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Federal Court Denies Class Certification on Grounds That Purchases of Un-sponsored ADRs Are Not “Domestic Transactions”

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On January 7, 2022, the U.S. District Court for the Central District of California denied a motion for class certification in *Stoyas v. Toshiba Corp.*,¹ a case asserting claims under the Securities Exchange Act of 1934 (the “Exchange Act”) and Japanese law on behalf of investors in un-sponsored American Depositary Receipts (“ADRs”).

The court held that the lead plaintiff incurred “irrevocable liability” for ADR purchases when the issuer’s common shares were purchased for conversion on a foreign exchange, and therefore that lead plaintiff’s purchases were not “domestic transactions” subject to the jurisdiction of U.S. courts. Although the law in this area is still developing, and the specific facts of the ADR purchases may vary case by case, the reasoning in this decision would limit the application of the U.S. securities laws to foreign issuers whose un-sponsored ADRs are sold in the U.S. over-the-counter (“OTC”) markets.

Background on ADRs

ADR programs enable U.S. investors to buy and sell interests in a foreign company’s stock on a U.S. exchange or market even though the foreign company’s underlying shares are not traded on a domestic exchange. With certain exceptions, ADR programs are registered with the SEC under the Securities Act of 1933, but the underlying shares are not registered. An ADR represents an interest in the shares of the non-U.S. company that have been deposited in the domestic bank. ADRs are either sponsored or un-sponsored, which reflects the level of involvement of the foreign company in making the ADRs available. Companies with sponsored ADRs appoint a domestic depository bank that holds the foreign stock and the sponsor lists the shares on a U.S. securities exchange, whereas un-sponsored ADRs are issued without the participation of the foreign company and trade in OTC markets. The *Stoyas* case concerns un-sponsored ADRs.

Stoyas v. Toshiba Corp.

In 2015, investors filed a putative securities fraud class action lawsuit against Toshiba in the Central District of California, alleging that Japanese government investigations “revealed widespread,

¹ No. 15-cv-4194 DDP (ECF No. 146).

deliberately fraudulent accounting practices” at the company.² Toshiba shares were publicly traded only on a Japanese stock exchange. As relevant here, one lead plaintiff—Automotive Industries Pension Trust Fund (“AIPTF”)—purchased 36,000 shares of unsponsored Toshiba ADRs in 2015 through transactions on an OTC market in the United States.³

In 2016, the district court dismissed AIPTF’s claim pursuant to the Supreme Court’s decision in *Morrison v. National Australia Bank Ltd.*⁴, which limits the extraterritorial reach of the U.S. securities laws to transactions in securities listed on domestic exchanges and domestic transactions in other securities. The district court held that the OTC market where the ADRs were purchased did not constitute a “national exchange,” and that there was no “domestic transaction” between ADR purchasers and Toshiba.⁵ On appeal, the Ninth Circuit agreed that the OTC market was not a national exchange but remanded the case for further consideration of whether the ADR purchases could constitute a “domestic transaction.” The Ninth Circuit followed other appellate courts and adopted the “irrevocable liability” test, under which a transaction is domestic if “irrevocable liability was incurred or the title passed in the United States.”⁶ On remand, plaintiffs amended their complaint to address the “irrevocable liability” test. In early 2020, the district court denied defendants’ motion to dismiss the amended complaint, holding that, on the basis of the pleadings alone, plaintiffs plausibly pleaded facts supporting an inference that irrevocable liability for AIPTF’s ADRs was incurred in the United States.

Plaintiffs asked the court to certify a class on February 19, 2021, and to appoint AIPTF as class representative for a class of “all persons who purchased [certain Toshiba] securities . . . using the facilities of the OTC market.” (Plaintiffs also sought to appoint a different investor as class representative for U.S. investors who purchased Toshiba shares directly from the Tokyo Stock Exchange and were pursuing Japanese law claims.)⁷ Defendants once again raised *Morrison* objections and argued that AIPTF could not be a class representative because it did not acquire its Toshiba securities in a domestic transaction. Further, at this class certification stage, defendants adduced evidence in support of their argument.

The evidence showed that AIPTF accessed the OTC market through its investment manager, Clearbridge Advisors LLC. On March 20, 2015, Clearbridge placed a buy order for unsponsored ADRs in New York through its broker, Barclays Capital, also located in New York. On March 23, 2015,

² *Stoyas v. Toshiba Corp.*, 896 F.3d 933, 937 n.1 (9th Cir. 2018).

³ The other two lead plaintiffs were an individual investor and a pension fund that purchased 343,000 shares of Toshiba’s common stock directly on the Japanese stock exchange.

⁴ 561 U.S. 247 (2010).

⁵ *Stoyas v. Toshiba Corp.*, 191 F. Supp. 3d 1080 (C.D. Cal. 2016), rev’d, 896 F.3d 933 (9th Cir. 2018).

⁶ *Stoyas v. Toshiba Corp.*, 896 F.3d 933, 948 (9th Cir. 2018). The Ninth Circuit held that if a transaction qualifies as a “domestic transaction” under *Morrison*, it is subject to the U.S. securities laws. *Id.* at 949. The Ninth Circuit thus split from the Second Circuit, which held in *Parkcentral Global Hub v. Porsche Automobile Holdings*, 763 F.3d 198 (2d Cir. 2014), that even a “domestic transaction” may nonetheless be so “predominantly foreign” that it is not subject to the U.S. securities laws. *Id.* at 950. This circuit split remains unresolved.

⁷ *Stoyas*, No. 15-cv-4194 DDP (ECF No. 108) (Defining the proposed class as “[a]ll persons who purchased securities listed under the ticker symbols TOSYY or TOSBF [between May 8, 2012 and November 12, 2015] using the facilities of the OTC Market (‘American Securities Purchasers’); and All citizens and residents of the United States who purchased shares of Toshiba 6502 common stock [between May 8, 2012 and November 12, 2015] (‘6502 Purchasers.’)”).

Barclays traders in New York and Japan purchased Toshiba common stock on a Japanese exchange for conversion on behalf of ClearBridge.⁸ Later that day, Barclays's employees in New York contacted the ClearBridge trader who placed the buy order to notify her of the price for the ADRs and asked if she agreed. ClearBridge's trader agreed, and Barclays then purchased the ADRs for AIPTF on the OTC Market using the OTC Link trading platform. On March 26, 2015, AIPTF paid for the ADRs by transferring \$922,057.20 to Barclays from its custodian bank in New York.

The critical question, according to the district court, was “whether AIPTF incurred irrevocable liability to take and pay for the ADRs in the United States or in Japan.”⁹ Plaintiffs argued that AIPTF incurred irrevocable liability at the moment Barclays executed its ADR order on March 23 in New York. Defendants argued, to the contrary, that AIPTF incurred irrevocable liability when the Toshiba common shares were purchased on the Japanese exchange for conversion. The court agreed with defendants, finding that “Plaintiffs’ argument glosses over the fact that AIPTF’s ability to acquire ADRs was contingent upon the purchase of underlying shares of common stock that could be converted into ADRs. . . . Once Barclays fully executed the purchase of common stock on the Tokyo Stock Exchange, AIPTF was bound to take and pay for the ADRs, once converted.”¹⁰ Thus, AIPTF became “logically and legally bound to perform its contractual obligations” at “[t]he moment Barclays completed the transaction for Toshiba common stock on the Tokyo Stock Exchange.”¹¹ The court further held that, “[b]ecause Plaintiffs cannot establish that AIPTF purchased the ADRs in a domestic transaction, Plaintiffs also cannot satisfy the typicality requirement” for class certification.¹² Accordingly, the court denied plaintiffs’ class certification motion with respect to unsponsored Toshiba ADR holders with prejudice. (The court also denied plaintiffs’ class certification motion with respect to the investors who purchased Toshiba common shares on the Tokyo exchange and pursued Japanese law claims, but did so without prejudice; the court ordered additional briefing on legal issues that it said were more appropriately addressed at summary judgment.)¹³

Implications

As a threshold matter, although the Ninth Circuit has suggested that OTC transactions in unsponsored ADRs may be subject to U.S. jurisdiction in some circumstances, the issue remains unsettled in other courts and may be litigated.

Even within the Ninth Circuit, the viability of such lawsuits is questionable under the district court’s reasoning in *Stoyas*. The fact that the court denied class certification for unsponsored ADR holders *with prejudice* suggests that the court viewed the lead plaintiff’s *Morrison* deficiencies as affecting all investors who held unsponsored Toshiba ADRs. Certainly, with respect to purchasers of unsponsored ADRs who seek to serve as a class representative, the decision demonstrates how

⁸ *Stoyas*, No. 15-cv-4194 DDP (ECF No. 114-12, Ex. K).

⁹ *Stoyas*, No. 15-cv-4194 DDP (ECF No. 146 at 6).

¹⁰ *Id.* at 7.

¹¹ *Id.* at 8.

¹² *Id.* at 10-11. The court separately denied without prejudice plaintiffs’ motion to certify a class of Japanese common stock holders and asked for additional briefing on legal issues raised by that motion. *Id.*

¹³ *Id.*

courts will analyze proposed class representatives for *Morrison* purposes by dissecting, as to that specific transaction, where the “irrevocable liability” was assumed. The court’s decision also hints at a bigger issue that the opinion did not address: how can a court certify *any* class of unsponsored ADR purchasers when a fact-intensive inquiry will be required to determine on an investor-by-investor basis which (if any) investors incurred irrevocable liability in the United States and are properly part of a class? This issue likely impacts, among other things, the ascertainability and predominance requirements of Rule 23, and could render class treatment inappropriate in securities class actions involving unsponsored ADR holders.

The fate of the Japanese law claims pursued by U.S. investors who purchased shares on the Tokyo exchange are uncertain, but the outcome of that dispute may also be of interest. The court denied class certification without prejudice and ordered additional briefing on key legal issues with respect to those investors; the court’s future decision on those claims may elucidate the extent to which U.S. purchasers on foreign exchanges may pursue securities class actions in U.S. courts, typically pursued under a theory of pendent jurisdiction, and may be the next significant decision to come out of this long-running litigation. We will continue to monitor the litigation, including any potential appeals, and issue additional alerts as events unfold.