ALERT MEMORANDUM

Another Twist in the Toshiba Securities Litigation: Denial of Class Certification Concerning Unsponsored ADRs

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On January 7, 2022, the district court in the long-running securities class action filed on behalf of investors in Toshiba's unsponsored ADRs delivered another curveball by denying class certification in its entirety. The case has previously spawned a number of notable decisions, with the district court initially dismissing the claims as extraterritorial under *Morrison*, the Ninth Circuit reversing in a decision holding (in conflict with the Second Circuit) that the presence of a domestic transaction satisfies *Morrison* and that any concerns about a foreign issuer's limited involvement in that transaction should be considered under the Exchange Act's flexible "in connection with" element, and the district court denying a motion to dismiss under those standards. In its most recent decision, however, the district court rejected the plaintiffs' class certification motion, holding that the named plaintiffs were atypical class representatives because they actually purchased the unsponsored ADRs in foreign transactions. The district court also denied class certification with respect to the plaintiffs' Japanese law claims concerning Toshiba's common stock, finding that those claims raised questions of Japanese law that would be more appropriately considered at the summary judgment stage.

The decision holds several important lessons for foreign issuers, including because it underscores the importance of pushing for extraterritoriality issues to be resolved at an early stage of the litigation. The decision also highlights that foreign-law securities claims can present complex and unsettled issues of foreign law, providing further support for dismissing such claims under comity principles.

Background[1]

In June 2015, three named plaintiffs ("Plaintiffs") brought a securities class action against Toshiba Corporation ("Toshiba") in the Central District of California.[2] The action was filed amid ongoing internal investigations ordered by the Japanese government that allegedly "revealed widespread, deliberately fraudulent accounting practices"[3] at the company, and contended that the discovery of the alleged fraud precipitated a decline of over 40% in the price of Toshiba securities.[4]

However, the action was perhaps most notable because Toshiba itself has not listed any securities for trading in the United States. Instead, its common stock is listed on the Tokyo Stock Exchange, and is only traded over-the-counter in the United States through an unsponsored ADR program established by a depository bank.[5] Plaintiffs' complaint nonetheless brought claims under the Exchange Act against Toshiba concerning those unsponsored ADRs, as well as claims under Japan's Financial Instruments & Exchange Act ("JFIEA") concerning Toshiba common stock.

Toshiba originally moved to dismiss the Exchange Act claims for failure to state a claim and the JFIEA claims on comity and *forum non conveniens* grounds. In particular, Toshiba argued that Plaintiffs had not adequately alleged that they purchased Toshiba securities on a domestic exchange or in a sufficiently domestic transaction, as required by the Supreme Court's decision in *Morrison*.[6] The district court accepted Toshiba's *Morrison* arguments, reasoning that Toshiba was not sufficiently involved in the sale of the unsponsored ADRs to satisfy the "spirit and law of *Morrison*."[7] The district court also dismissed Plaintiffs' JFIEA claims on comity and *forum non conveniens* grounds.[8]

Plaintiffs appealed to the Ninth Circuit, which reversed.[9] The Ninth Circuit rejected the district court's reasoning that engaging in a domestic transaction was necessary but not sufficient for the Exchange Act to apply under *Morrison*, disagreeing with a prior Second Circuit ruling that even domestic transactions could be extraterritorial under *Morrison* if they are predominantly foreign.[10] Instead, the Ninth Circuit held that the presence of a domestic transaction satisfies *Morrison*, and that questions concerning a foreign issuer's involvement in the transaction should be considered under the separate "in connection with" element.[11] While the Ninth Circuit determined that Plaintiffs did not adequately allege a domestic transaction or Toshiba's participation in the issuance of ADRs, it granted Plaintiffs leave to amend.[12]

Applying the standards articulated by the Ninth Circuit, the district court denied Toshiba's motion to dismiss that amended complaint.[13] With respect to Toshiba's unsponsored ADRs, the district court held that Plaintiffs adequately alleged that they had engaged in domestic transactions,[14] including because they alleged that: the placement of the purchase order, payment for the securities, and transfer of title took place in the United States; Plaintiff's investment manager, its broker and the utilized trading platform were located in New York; the purchase order and trade confirmation were routed through servers in New York; the depository bank issued the ADRs from the bank's office in New York; Plaintiffs paid for the ADRs using a New York-based bank; and the transfer

[1] Further background on the Toshiba securities litigation can be found in Cleary Gottlieb's two prior memorandums on the subject, which can be accessed here and here.
[2] *Stoyas v. Toshiba Corp.*, 191 F. Supp. 3d 1080, 1084-86 (C.D. Cal. 2016).
[3] *Stoyas v. Toshiba Corp.*, 896 F.3d 933, 937 n.1 (9th Cir. 2018).
[4] *Stoyas*, 191 F. Supp. 3d at 1085.
[5] *Stoyas*, 896 F.3d at 939.
[6] *Stoyas*, 191 F. Supp. 3d at 1088-89; *see also Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010).
[7] *Stoyas*, 191 F. Supp. 3d at 1094-95.
[8] *Id.* at 1099-1100.
[9] *Stoyas*, 896 F.3d at 952.
[10] *Id.* at 949; *but see Parkcentral Global Hub v. Porsche Automobile Holdings*, 763 F.3d 198 (2d Cir. 2014).
[11] *Stoyas*, 896 F.3d at 951.
[12] *Id.* at 952.
[13] *Stoyas v. Toshiba Corp.*, 424 F. Supp. 3d 821, 830 (C.D. Cal. 2020).
[14] *Id.* at 826.

of title was recorded in New York.[15] The district court further concluded that Plaintiffs adequately alleged that Toshiba was involved in the issuance of the ADRs.[16] The district court also rejected Toshiba's arguments that comity and *forum non conveniens* required dismissal of the JFIEA claim.[17]

The case subsequently proceeded to discovery, and Plaintiffs moved to certify a class consisting of (1) all persons who purchased the ADRs using the facilities of the OTC Market and (2) all citizens and residents of the United States who purchased Toshiba 6502 common stock, during the relevant time period.[18]

Class Certification Decision

On January 7, 2022, the district court denied Plaintiffs' class certification motion.

With respect to the Exchange Act claims concerning Toshiba's unsponsored ADRs, the district court held that Rule 23's typicality requirement was not satisfied because Plaintiffs did not acquire their securities in domestic transactions.[19] The district court's conclusion stemmed from the fact that Plaintiffs' "ability to acquire ADRs was contingent upon the purchase of underlying shares of common stock [in Japan] that could be converted into ADRs" and once the underlying common stock was acquired Plaintiffs were "bound to take and pay for the ADRs, once converted."[20] In reaching this conclusion, the district court rejected Plaintiffs' arguments that they incurred irrevocable liability when their investment manager's broker executed the order for the unsponsored ADRs in New York, and that the transaction should be viewed as two distinct trades: an initial foreign transaction by the broker involving the underlying stock followed by a separate domestic transaction involving the ADRs.[21] In doing so, the district court pointed to evidence that the broker's traders in Japan "executed the purchase of common stock for conversion, on behalf of [Plaintiffs' investment manager]," and that after the purchase of the underlying stock took place, Plaintiffs were "bound to take and pay for the ADRs, once converted."[22] Therefore, "the triggering event that caused [Plaintiffs] to incur irrevocable liability occurred in Japan" when its investment manager's broker acquired the shares of the underlying stock in Japan.[23] In a footnote, the district court acknowledged that it had previously found that Plaintiffs adequately alleged a domestic transaction at the pleading stage, but clarified that it did so because there "were no allegations that [Plaintiffs] first purchased the underlying shares of Toshiba common stock in a foreign transaction prior to conversion into ADRs."[24] The district court also noted that Plaintiffs failed to identify a case where the purchase or sale of unsponsored ADRs constituted a domestic transaction.[25]

With respect to the JFIEA claim concerning Toshiba's common stock, the district court denied class certification without prejudice on the ground that there were "potentially dispositive questions of law" regarding those claims that "are more appropriate to a motion for summary judgment rather than a class certification motion."[26] These issues of Japanese law were: (1) whether Plaintiffs lacked statutory standing to bring the JFIEA claims because they were beneficial owners of the securities rather than direct owners; and (2) whether Plaintiffs' interests conflict with those of the other proposed class members due to different damages being available to different groups of potential plaintiffs under the JFIEA.[27]

Takeaways

The latest decision in the Toshiba securities litigation has several significant implications for foreign issuers.

[15] *Id*.
[16] *Id*. at 828.
[17] *Id*. at 829.
[18] *Stoyas v. Toshiba Corp.*, No. 2:15-cv-04194 DDP-JC, 2022 WL 80469, at *3 (C.D. Cal. Jan. 7, 2022).
[19] *Id*. at *10.
[20] *Id*. at *7-8.
[21] *Id*. at *8-9.
[22] *Id*. at *7-8.
[23] *Id*. at *10.
[24] *Id*. at *10 n.9.
[25] *Id*.
[26] *Id*. at *13.
[27] *Id*. at *12-13.

First, the decision underscores the importance of pushing district courts to require detailed allegations about the location of transactions in securities not traded on domestic exchanges at the motion to dismiss stage. Securities plaintiffs often argue that complaints do not need to contain detailed evidence with respect to certain elements of their claims, including because traditional discovery is not available at the pleading stage as a result of the PSLRA's discovery stay. But that reasoning has limited force with respect to allegations concerning the location of the plaintiffs' transactions, which rest on evidence largely within the plaintiffs' control. It thus seems fair to require plaintiffs to provide detailed information about the location of their transactions in their complaints, as certain courts have done,[28] in order to avoid burdening foreign issuers with full-scale discovery based on claims that do not actually fall within the scope of the federal securities laws. And where plaintiffs survive the pleading stage based on limited allegations about the location of their transactions, foreign issuer defendants would be well served to prioritize discovery into evidence on that subject.

Second, the decision also highlights that extraterritoriality issues can present significant obstacles to class certification. In prior cases, certain courts have accepted that the individualized issues required to determine the location of each transaction entered into by each class member may defeat Rule 23's predominance requirement.[29] The *Toshiba* decision presents an additional argument against certification where the named plaintiff can be considered atypical because they engaged in foreign transactions. Moreover, even if it is uncertain whether a plaintiff's transactions were foreign or domestic, the typicality requirement can be defeated if resolving that issue will require considerable amounts of their time and prejudice absent class members.[30]

Third, the district court's recognition that the JFIEA claims raised multiple potentially dispositive questions of Japanese law, which it did not believe were appropriate to resolve on a class certification motion, further underscores that American courts should be hesitant to entertain class actions asserting foreign-law securities claims. In recent years, securities plaintiffs have increasingly attempted to assert foreign-law claims about securities traded on foreign exchanges, asking courts presiding over class actions asserting Exchange Act claims about related securities traded on U.S. exchanges to exercise supplemental jurisdiction over such claims.[31] These types of foreign-law securities class actions in American courts present deep conflicts with *Morrison*, which held that transactions in such securities fall outside the scope of the federal securities laws, including because they pose the threat of turning U.S. courts into "the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."[32] As the *Toshiba* decision shows, they also burden district courts with unsettled questions of foreign law, which would be best considered by foreign courts. The decision therefore provides additional ammunition for defendants arguing that such claims should be dismissed at an early stage on comity or *forum non conveniens* grounds.

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[28] *See, e.g., In re Petrobras Sec. Litig.*, 150 F.Supp.3d 337, 340 n.6 (S.D.N.Y. 2015) (adequately pleaded claims included domestic area codes of participating traders); *In re iAnthus Capital Holdings, Inc. Sec. Litig.*, No. 20-cv-3135 (LAK), 2021 WL 3863372, at *2-7 (S.D.N.Y. Aug. 30, 2021) (domestic repayment address for debentures not sufficient).

[29] *See, e.g., In re Petrobras Sec. Litig.*, 862 F.3d 250, 261 (2d Cir. 2017).

[30] *See Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 176, 180 (2d Cir. 1990).

[31] Jared Gerber et al., *Foreign Securities Class Actions 10 Years After Morrison*, LAW360 (2020), https://www.law360.com/newyork/articles/1312570/foreign-securities-class-actions-10-years-after-morrison.

[32] *Morrison*, 561 U.S. at 270.