

## Central District of California: Plaintiffs Adequately Alleged That (1) Purchases of Un-sponsored ADRs Constituted “Domestic Transactions,” and (2) the Foreign Issuer’s Alleged Fraud Was “in Connection With” Those Transactions

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On January 28, 2020, the Central District of California declined to dismiss a securities fraud action arising out of purchases of unsponsored American Depositary Receipts and Shares (ADRs) on over-the-counter markets.<sup>[1]</sup> *Stoyas v. Toshiba Corp.*, 2020 WL 466629 (C.D. Cal. 2020) (Pregerson, J.). The court held plaintiffs adequately alleged that the purchases were “domestic transactions” for purposes of the test set forth in *Morrison v. National Australia Bank*, 561 U.S. 247 (2010), and that alleged misstatements by the foreign issuer of the underlying securities were made “in connection with” those ADR transactions.<sup>[2]</sup>

### Background

The Central District of California had previously held that Section 10(b) does not reach securities fraud transactions in unsponsored ADRs. *Stoyas v. Toshiba Corp.*, 191 F. Supp. 3d 1080 (C.D. Cal. 2016). Based on this determination, the court granted defendants’ motion to dismiss and denied plaintiffs leave to amend.

On July 17, 2018, the Ninth Circuit reversed the Central District of California’s decision. *Stoyas v. Toshiba Corp.*, 896 F.3d 933 (9th Cir. 2018). The Ninth Circuit held that *Morrison* does not preclude Section 10(b) claims in connection with unsponsored ADRs, provided that the ADRs were purchased or sold in a “domestic transaction.”<sup>[3]</sup> The Ninth Circuit reasoned that *Morrison* instructs courts “to examine the location of the transaction[;] it does not matter that a foreign entity was not engaged in the transaction.” The Ninth Circuit adopted the test set forth in *Absolute Activist Value Master Fund v. Ficeto*, 677 F.3d 60 (2d Cir. 2012), for determining whether the securities were purchased or sold in a “domestic transaction.” To plead a “domestic transaction” under the *Absolute Activist* test, “a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States.” *Absolute Activist*, 677 F.3d 60.<sup>[4]</sup>

The Ninth Circuit agreed with the district court that plaintiffs failed to allege the existence of a “domestic transaction.” The Ninth Circuit further found that plaintiffs failed to plead that the foreign issuer’s alleged fraud was “in connection with” a “domestic transaction.” The court explained that in order “for fraud to be in connection with the purchase or sale of any security, it must touch the sale—i.e., it must be done to

induce the purchase at issue.” The court suggested that plaintiffs may need to allege facts concerning the foreign issuer’s involvement in the ADRs to satisfy this requirement.

The Ninth Circuit reversed the district court’s decision and remanded to permit the plaintiffs an opportunity to amend their complaint. After plaintiffs amended their complaint, defendants again moved to dismiss.

**Central District of California Finds Plaintiffs Adequately Alleged a “Domestic Transaction” and Satisfied the “in Connection with” Requirement**

The Central District of California held that the amended complaint adequately alleged that plaintiffs incurred irrevocable liability for the ADRs in the United States by pleading, *inter alia*, that the buy order, purchase price payment, and transfer of title took place in the United States. The court therefore determined that plaintiffs adequately alleged a “domestic transaction” for *Morrison* purposes. The court rejected defendants’ contention that “[p]laintiffs purchased the underlying securities in a foreign transaction before converting the foreign stock into ADRs” because there were no allegations of a two-step transaction. Rather, “[p]laintiffs allege[d] that a single transaction occurred”—the purchase of ADRs on an over-the-counter market in the United States.

The court also found that plaintiffs “sufficiently alleged [the foreign issuer’s] plausible participation in the establishment of the ADR program.” Plaintiffs alleged that one of the banks that offered the unsponsored ADRs was among the foreign issuer’s ten largest shareholders and further alleged that it was unlikely the bank could have acquired so many shares “without the consent, assistance or participation of” the foreign issuer. The court held these allegations satisfied the “in connection with” requirement.

[1] “An ADR is a receipt that is issued by a depository bank that represents a specified amount of a foreign security that has been deposited with a foreign branch or agent of the depository, known as the custodian.” *Stoyas v. Toshiba Corp.*, 191 F. Supp. 3d 1080 (C.D. Cal. 2016).

[2] In *Morrison*, the Supreme Court held that Section 10(b) applies only to (1) “transactions in securities listed on domestic exchanges,” and (2) “domestic transactions in other securities.” 561 U.S. 247.

[3] Please [click here](#) to read our discussion of the Ninth Circuit’s decision in *Stoyas*.

[4] Please [click here](#) to read our discussion of the Second Circuit’s decision in *Absolute Activist*.

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