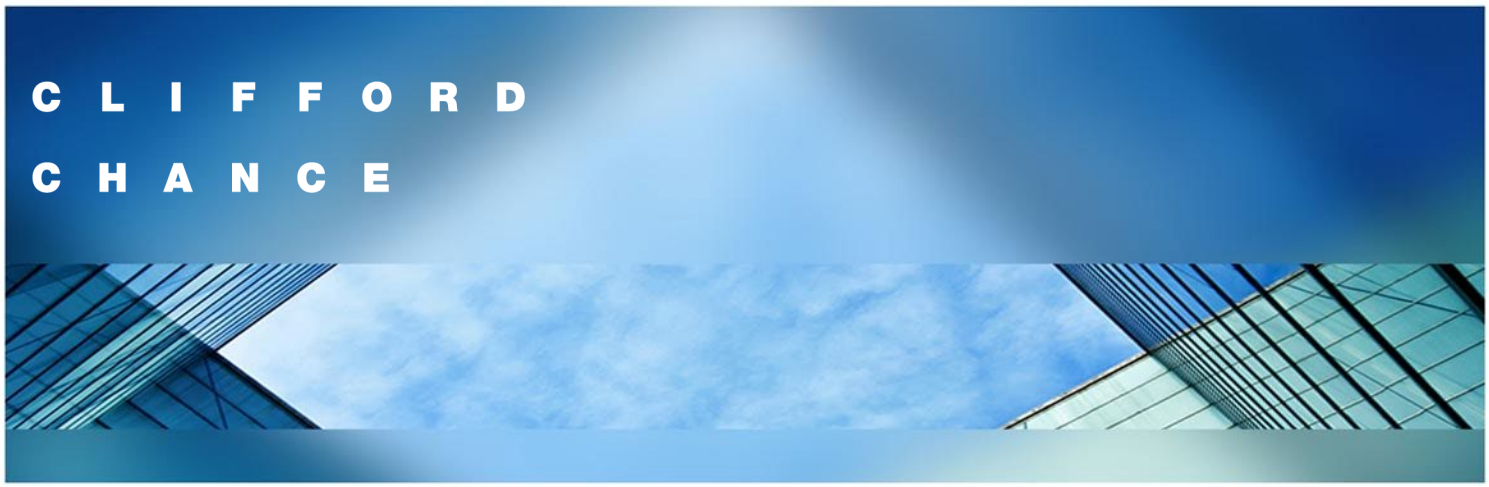

A YEAR ON FROM *STOYAS*: NON-US ISSUERS FACE HEIGHTENED RISK OF US SECURITIES LITIGATION

Last year, a US federal court in California held that foreign issuers with unsponsored American Depository Receipts ("ADRs") traded in the United States can be liable under the US securities laws for misstatements that are made abroad. This decision opened the door for plaintiffs to bring lawsuits against these issuers even though they were not involved in the formation of the ADR facility. The decision theoretically could also extend to so-called "F Shares" that may be even further removed from the issuer's control. Unsurprisingly, emboldened plaintiffs have filed a string of such claims against foreign issuers.

Background

Historically, US courts were a hotbed of stock drop suits against foreign issuers based on a variety of factors, including the availability of "class action" litigation, contingency fees, and the lack of a "loser pays" rule. As a result, plaintiffs often pursued cross-border securities suits in the United States, even for claims lacking any real connection to the US market.

This changed with the Supreme Court's landmark 2010 decision in *Morrison v. National Australia Bank*, which held that the general antifraud provision of the federal securities laws—Exchange Act Section 10(b) (and Rule 10b-5 thereunder)—do not apply extraterritorially. Instead, *Morrison* held, they reach only claims premised on plaintiffs' "domestic" US transactions.[1]

Following *Morrison*, US courts generally took a restrictive view of US jurisdiction over foreign issuers. For example, in 2014, the federal appeals court in New York held that even where plaintiff-investors transact domestically, *Morrison* forbids section 10(b) claims premised on defendants' "wholly foreign activity."[2] In *Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE*, the court rejected

The *Stoyas* case opened the door to suits against foreign issuers for securities that trade in US without their involvement.

- An **American Depositary Share** ("**ADS**") is a US dollar denominated equity share of a foreign issuer available for purchase in the US, represented by an ADR. ADS are issued by a US bank, referred to as a "depositary bank." Non-US issuers can establish **Sponsored ADR** programs to facilitate investment by US investors. Sponsored ADRs are subject to suits under the Exchange Act. The new risk relates to **Unsponsored ADRs**, which are established by a depositary bank *without* an issuer's participation.
- **F-Shares** are established by US broker-dealers and represent a foreign issuer's ordinary shares that are priced in US dollars and are normally settled in the issuer's local market, (but may sometimes be settled in the US).

1 561 U.S. 247 (2010).
2 763 F.3d 198 (2d Cir. 2014).

claims premised on allegations that misstatements abroad affecting foreign-listed securities were subject to US securities laws because there were knock-on effects on US traded swaps. In so holding, the court emphasized that *Morrison*'s bar on extraterritorial application of section 10(b) would be "seriously undermine[d]" by claims connected to the US only by domestic transactions that "foreign [issuer] defendants were completely unaware of."

The *Stoyas* case

This trend, however, was not followed in California. Instead, in *Stoyas v. Toshiba Corporation*, two California federal courts held that US courts have jurisdiction to hear securities fraud claims premised on entirely foreign statements made by a Japanese company—Toshiba Corporation—that only has over-the-counter unsponsored ADRs and F-shares traded in the US.[3]

The trial court initially dismissed this claim on *Morrison* grounds, but in 2018, the federal appeals court in California, reversed the trial court's dismissal. The appeals court directly repudiated *Parkcentral* and narrowly interpreted *Morrison* to hold that a domestic transaction by plaintiffs—on its own—suffices to state a properly domestic application of section 10(b), even as to claims premised on defendants' wholly foreign misstatements. The court downplayed concerns that its holding would dramatically expand US litigation risk to unsuspecting foreign issuers, reasoning investors would still need to establish under section 10(b) that a foreign issuer's alleged misstatements were "in connection with" plaintiffs' domestic transactions.

Subsequently, in January 2020, guided by the appellate court's decision, the trial court presiding over the revived claims against Toshiba rejected the issuer's renewed motion for dismissal. Its decision suggested the guardrails identified by the California appeals court would not meaningfully constrain suits against foreign issuers, as the court rejected Toshiba's argument that application of US laws was inappropriate because plaintiffs failed to allege that Toshiba "had anything at all to do with" plaintiffs' purchase of Toshiba's unsponsored ADRs. According to the court, despite Toshiba's lack of sponsored ADR program in the US market, Toshiba's foreign misrepresentations were made "in connection with" plaintiffs' ADR transactions and, therefore, subject to US securities laws, because domestic depositary banks—which issue ADRs for US trading—*typically* receive a foreign issuer's consent before establishing unsponsored ADRs programs. The court further concluded it was plausible that Toshiba was involved in the establishment of its unsponsored ADRs because it was "unlikely" that a particular US depositary bank—one of Toshiba's largest shareholders—issued ADRs for sale to US investors "without the consent, assistance or participation of Toshiba." Finally, the court held that plaintiffs' allegations regarding domestic transactions, which was based on the location of the plaintiffs' investment manager, broker, payment bank, and depositary bank—demonstrated their trades were adequately "domestic" under *Morrison*.

[3] 424 F.Supp.3d 821 (C.D. Cal. 2020); 896 F.3d 933 (9th Cir. 2018).

Insights beyond *Stoyas*

Unsurprisingly, the *Stoyas* decision opened the gates for claims against non-listed foreign issuers, premised on domestic transactions in unsponsored ADRs or F-shares. Following the decision, over a dozen class actions have been filed against non-US issuers, based on trades in unsponsored ADRs or F-shares. There is no reason to expect this trend to change until the US Supreme Court resolves the split between California and New York federal appeals courts and determines whether, consistent with *Morrison*, plaintiffs' "domestic" transactions in securities are merely necessary, or alone sufficient, for section 10(b) to apply to claims based on a foreign issuer's wholly foreign activity. That could take years: Supreme Court review is discretionary, and rarely granted.

That said, we anticipate the coming months will paint a clearer picture of how successful these claims will be. In US litigation, a motion to dismiss the complaint is an important first opportunity to end a securities fraud class action, *before* plaintiffs are permitted to obtain costly discovery from defendants (i.e., the exchange of evidence) and courts are beginning to issue these decisions in the post-*Stoyas* claims against foreign issuers. Those decisions suggest foreign issuers may emphasize threshold grounds for dismissal, such as that the US federal courts lack specific "personal jurisdiction" over a foreign issuer for alleged misstatements abroad that do not directly target US investors.[4] Likewise, especially where US investors hailing from outside of California sue there in an effort to capitalize on the *Stoyas* precedent, foreign issuers may emphasize that an alternative forum—such as their home country, where shares are traded and supposed misstatements originated—may be a more suitable forum to resolve the dispute.[5]

Of course, it remains to be seen how the courts will continue to develop the *Stoyas* line of cases. In the meantime, foreign issuers eager to avoid costly and time-consuming securities fraud class actions in the US should monitor this developing trend. A first step may include an assessment of whether ADRs or F-shares trade in the US without their involvement.

4 *Joseph Amann v. Metro Bank PLC et al*, 19-cv-04739, Dkt. 61 (C.D. Cal. Dec. 2, 2020).
5 *Church v. Glencore PLC*, 18-cv-11477, 2020 WL 4382280 (D.N.J. July 31, 2020).

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