Ninth Circuit Holds That Section 10(b) Reaches Domestic Purchases of Unsponsored ADRs and That the Supreme Court's *Morrison* Decision Does Not Preclude Claims Against Issuers Arising Out of Such Purchases

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On July 17, 2018, the Ninth Circuit issued an opinion in ***Automotive Industries Pension Trust Fund v. Toshiba Corp.*, No. 16-56058 (9th Cir. July 17, 2018)**, holding that the Supreme Court's *Morrison* decision does not preclude purchasers of Toshiba's unsponsored American Depository Shares or Receipts ("ADRs") in the over-the-counter ("OTC") market from maintaining securities claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 against Toshiba. The Ninth Circuit's decision reverses the district court's dismissal of the securities claims under *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010). The Ninth Circuit held that *Morrison* permits such claims, so long as plaintiffs are able to plead and ultimately establish that their purchases occurred within the United States in accordance with the "irrevocable liability test" previously adopted in other circuits to determine whether the sale or purchase of securities not occurring on an exchange takes place in the United States. For now, at least within the Ninth Circuit, this ruling eliminates for the purposes of *Morrison* the distinction between sponsored and unsponsored ADR programs and makes clear that issuers with unsponsored ADR programs can be subject to private federal securities claims relating to domestic ADR transactions. As a result, under the Ninth Circuit's ruling, it is possible that issuers which took no action to cause the unsponsored ADRs to be traded within the United States could nonetheless be subject to Section 10(b) claims.

The Ninth Circuit addressed three questions: (1) whether ADRs are securities; (2) whether the OTC market on which the ADRs were purchased constituted an exchange; and (3) whether *Morrison* precluded the claims.

The Ninth Circuit's answers to the first two questions are consistent with numerous previous decisions holding that (1) ADRs are securities, and (2) the OTC market does *not* constitute an exchange. The third question—i.e., how to apply *Morrison* to unsponsored ADR purchases in the OTC market—is a question of first impression at the Circuit Court of Appeal level. The district court's opinion insulating issuers from Section 10b claims under *Morrison* with respect to claims by U.S. OTC purchasers of unsponsored ADRs was, prior to the Ninth Circuit's opinion, the only published decision to address the application of *Morrison* to unsponsored ADR programs directly.

In *Morrison* and cases throughout the country interpreting it, two independent paths to satisfying the domestic transaction requirement of *Morrison* have emerged. One, the transactions at issue are within the scope of Section 10(b) if they occur on a *domestic exchange*. Two, transactions are within the scope of Section 10(b) if they *otherwise occur within the United States*, even if off-exchange. The Ninth Circuit's conclusion that the OTC Link is not an exchange meant that plaintiffs' claims could not satisfy the first of *Morrison's* independent prongs for permitting Section 10(b) claims. However, the Ninth Circuit concluded that the purchases of Toshiba's ADRs in the U.S. OTC market could satisfy *Morrison's* second prong, provided plaintiffs can satisfy the "irrevocable liability" test applied by other circuits to determine where a purchase or sale of a security off-exchange occurs. Under this test, courts consider where purchasers incurred the liability to take and pay for securities, and where sellers incurred the liability to deliver securities. If irrevocable liability for either is incurred inside the United States, then the transaction is

deemed domestic, and potentially subject to the Exchange Act. Factual allegations related to the contract formation, placement of purchase orders, passing of title, and the exchange of money inform the analysis. Ultimately, the Ninth Circuit found that the plaintiffs' complaint failed to sufficiently plead that the relevant transactions occurred in the United States. But the Court found that plaintiffs could likely amend their complaint to do so, and therefore remanded the case to the district court.

The Ninth Circuit's ruling rejects the notion that, under *Morrison*, a domestic transaction is a necessary but not necessarily sufficient condition to the maintenance of a private securities claim. That "necessary, but not sufficient condition" rationale was employed by the district court in dismissing the claim, but the Ninth Circuit in its decision concludes that a domestic transaction is sufficient under *Morrison*. As a result of this decision, foreign corporations with unsponsored ADR programs in the United States may well see an increase in Exchange Act cases.

Circuit Judge Kim McLane Wardlaw wrote the opinion and was joined by Circuit Judge William A. Fletcher and District Court Judge Wiley Y. Daniel of the U.S. District Court for Colorado, sitting by designation.

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