Section 16(b) Claim for OTC-Traded Security Dismissed Based on Impermissible Extraterritoriality

30 May 2025

On May 23, 2025, the U.S. District Court for the Southern District of New York dismissed a shareholder derivative action against Koichi Ishizuka ("Ishizuka") and White Knight Co. Ltd. ("White Knight" and, together with Ishizuka, the "Defendants") that sought disgorgement of short-swing profits allegedly derived from transactions in the common stock of Next Meats Holdings, Inc. ("Next Meats") in violation of Section 16(b) of the Securities Exchange Act of the 1934, as amended (the "Exchange Act"), on the basis that applying Section 16(b) to the transactions at issue would be "impermissibly extraterritorial."[1] The case represents one of the first to consider the extraterritoriality of Section 16(b).

Background. Next Meats is a food-tech venture company incorporated in Nevada, with its principal offices in Tokyo, Japan. Although its common stock was registered under Section 12(g) of the Exchange Act at the time of the transactions in question,[2] its common stock did not, nor does it now, trade on a U.S. securities exchange. Instead, the common stock of Next Meats trades over-the-counter ("OTC") under the stock symbol "NXMH."

According to the opinion, on May 24, 2022, White Knight, a Japanese entity owned and controlled by Ishizuka, the chief executive officer of Next Meats, sold 461,714 shares of Next Meats' common stock to an unaffiliated Japanese entity for $0.85 per share (the "May 2022 Transaction"). Less than six months later, on November 22, 2022, White Knight purchased an aggregate of 121,092,733 shares of Next Meats' common stock for $0.001 per share, for a total of approximately $121,093 (the "November 2022 Transaction" and, together with the May 2022 Transaction, the "Transactions"). On January 4, 2023, the Defendants filed a Form 4 with the SEC reporting the November 2022 Transaction. Shortly thereafter, Next Meats received a demand from a shareholder of Next Meats to prosecute the Defendants under Section 16(b) of the Exchange Act. The Defendants responded to the demand on February 22, 2023, arguing that, among

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1 *Rubenstein v. Ishikuza, et. al.*, No. 23-CV-4332 (MMG) (S.D.N.Y. May 23, 2025).

2 On December 3, 2024, Next Meats filed a Form 15 with the Securities and Exchange Commission (the "SEC") terminating the registration of its common stock under Section 12(g) of the Exchange Act.

other things, applying Section 16(b) to the Transactions would constitute an impermissible extraterritorial application of Section 16(b).

Analysis. Section 16(b) of the Exchange Act imposes strict liability on statutory "insiders" of an issuer (its officers, directors and shareholders owning greater than 10% of a class of its outstanding equity securities registered under Section 12 of the Exchange Act) in respect of "short-swing profits," requiring them to disgorge to the issuer any profits gained from the purchase and sale, or sale and purchase, of the issuer's registered equity securities within any six-month period.[3] In the case of the Transactions, the Defendants were deemed "insiders" by virtue of their ownership of more than 10% of the common stock of Next Meats. The Transactions, which occurred within six months of each other, generated profits of $391,995 for the Defendants (calculated pursuant to the rules promulgated under Section 16(b)).

The Defendants argued, however, that because the Transactions occurred outside the United States, and Next Meats' common stock was not listed on a U.S. exchange, Section 16(b) should not apply. In general, an assumption against extraterritoriality exists where a statute is primarily concerned with domestic conditions.[4] To interpret this presumption against extraterritoriality with respect to the provisions of the Exchange Act, courts have looked to the "transactional test" set out by the Supreme Court of the United States in *Morrison v. National Australia Bank Ltd.*[5] Under the "transactional test" set out in *Morrison*, a plaintiff may bring an action alleging that a transaction violates the Exchange Act if either (i) the transaction involved "a security listed on a U.S. exchange"[6] or (ii) the transaction occurred in the United States.[7]

As to whether the Transactions involved securities "listed on a U.S. exchange," the plaintiff argued that securities that trade only on the OTC market in the United States are considered "listed on a domestic exchange" for purposes of the *Morrison* test. The court rejected this argument, noting that for over a decade, courts in the Second Circuit

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3 Statutory insiders of foreign private issuers are exempt from the provisions of Section 16 pursuant to Rule 3a12-3(b) under the Exchange Act.

4 *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247, 255 (2010).

5 *See, e.g., Canoo Inc. v. DD Glob. Holdings, Ltd.*, No. 22-CV-03747 (MKV), 2023 WL 6162296, at *4-6 (S.D.N.Y. Sept. 21, 2023).

6 As to the prong of the *Morrison* test involving securities listed only a U.S. exchange, it is generally not relevant whether the transaction at issue actually occurs on a U.S. exchange. *See In Re Shanda Games Ltd. Sec. Litig.*, 128 F.4th 36, 42-43 (2d Cir. 2025); *but see City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 181 (2d Cir. 2014) (holding that a purchase of a foreign-issued security on a foreign exchange involving a security that is dual listed on a U.S. exchange does not satisfy the first prong of the *Morrison* test).

7 *Morrison*, 561 U.S. at 269-70.

have consistently found that the OTC market is not a domestic exchange for purposes of the *Morrison* test.[8]

With regard to whether the Transactions occurred in the United States, a transaction occurs in the United States for purposes of the *Morrison* test if the parties incurred liability in the United States (meaning that the parties incurred an irrevocable obligation to take and pay for or to deliver, as applicable, securities within the United States) or if title to securities was transferred in the United States.[9] The opinion notes that all contractual steps for the Transactions were carried out in Japan and that the plaintiff failed to allege any facts supporting a plausible inference that the Defendants incurred irrevocable liability in the United States. Additionally, the opinion rejected the plaintiff's argument that transfer of title to the common stock took place in the United States because Next Meats' transfer agent had a mailing address in New Jersey, stating that the recording of a transaction by a transfer agent located in the United States does not determine the location of the transfer of title. As the plaintiff did not allege any facts that would support the argument that irrevocable liability was incurred in the United States, and the court was unpersuaded by the plaintiff's argument that title to the common stock was transferred in the United States, the court found that the second prong of the *Morrison* test was also not satisfied.

Takeaways. While the decision remains subject to appeal, it underscores courts' general reluctance to apply statutes that are primarily concerned with matters that occur in the United States to extraterritorial transactions absent a clear affirmative intention from Congress that a statute should have an extraterritorial effect. Nevertheless, the decision in Next Meats does not preclude the application of Section 16(b) to an extraterritorial transaction under a different set of facts. In addition, insiders of issuers with equity securities registered under Section 12 of the Exchange Act, but only traded on OTC markets, should be mindful of the potential application of Section 16(b) for transactions that may have a closer nexus to the United States.

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Please do not hesitate to contact us with any questions.

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[8] See, e.g., *In re Petrobras Sec.*, 862 F.3d 250, 262 (2d Cir. 2017); *In re iAnthus Cap. Holdings, Inc. Sec. Litig.*, No. 20-CV-03135 (LAK), 2021 WL 3863372, at *2-3 (S.D.N.Y. Aug. 30, 2021); *In re Poseidon Concepts Sec. Litig.*, No. 13-CV-01213 (DLC), 2016 WL 3017395, at *12 (S.D.N.Y. May 24, 2016); *In re Sanofi Aventis Sec. Litig.*, 293 F.R.D. 449, 457 (S.D.N.Y. 2013).

[9] *See Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68-69 (2d Cir. 2012).

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