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U.S. Supreme Court Limits Private Suits Against Investment Funds

There is no implied private right of action in Section 47(b) of the Investment Company Act (ICA) allowing private parties to sue for rescission of contracts that allegedly violate the ICA, the Supreme Court held last week. *FS Credit Opportunities Corp. v. Saba Capital Master Fund, Ltd.,* No. 24-345. In a 6-3 decision, the conservative justices extended the Court's series of decisions declining to find an implied private right of action, this time addressing the ICA. The decision restricts private litigation under the ICA and provides some assurance of greater predictability to managers of closed-end funds.

The case arose when hedge funds ("Saba") bought shares in investment companies that managed closed-end funds ("Funds") governed by the ICA. Saba sought to identify low-performing closed-end funds and buy enough shares to influence the fund's market value. To discourage activist investors, the Funds had adopted resolutions providing that a shareholder owning 10% or more shares would be deprived of the right to vote the shares at and above the 10% threshold, unless two-thirds of the other shareholders affirmatively allowed it. Saba sued, seeking a declaratory judgment that the Funds' resolutions violated the one-share, one-vote mandate of the ICA. Saba also sought rescission of the resolutions.

The Southern District of New York held that the resolutions violated the ICA because the shares at and above the 10% threshold were no longer treated as "voting" shares, and because some shareholders could vote but others could not. The district court granted Saba summary judgment. Following *Oxford Univ. Bank v. Lansuppe Feeder, LLC*, 933 F. 3d 99, 109 (2d Cir. 2019), the district court held that Section 47(b) of the ICA created an implied private right of action permitting rescission, and it rescinded the Funds' resolutions. The Second Circuit affirmed.

The Supreme Court granted certiorari to determine whether Section 47(b) of the ICA creates an implied private right of action to sue for rescission of contracts which allegedly violate the ICA. The Court's decision would resolve a circuit split: the Third and Ninth Circuits have held, and the Fourth Circuit has agreed in an unpublished opinion, that there is no implied private right of action under Section 47(b), while the Second Circuit has held that there is. Agreeing with the three circuits, the Court held there was no implied private right of action in Section 47(b) of the ICA.

Writing for the conservative majority, Justice Amy Coney Barrett began the Court's analysis by examining the text and structure of the ICA. Analyzing the text, the Court opined that Section 47(b) has no language about individual rights and instead provides directions to courts. While the section provides for recission, the Court noted that rescission is "a remedy, not a cause of action." Considering the structure, the Court found that the Securities and Exchange Commission (SEC) enforces the ICA, and the ICA expressly authorizes two private rights of action in different situations. According to the Court, this demonstrates that Congress knew how to expressly grant the right to sue, but it chose not to do so here. The Court further concluded that the phrase "rescission at the instance of any party" in Section 47(b) cannot be read to imply a private right of action, as the language says nothing about a right to sue.

The Court then distinguished *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U. S. 11, 18 (1979) (*TAMA*). In *TAMA*, the Court held that the Investment Advisers Act (IAA)—a companion statute to the ICA, enacted at the same time with similar provisions—created a private right of action for rescission of a contract that violates the IAA. The *TAMA* Court based its holding on the phrase “shall be void” in the IAA. The same language (“shall be void”) was in Section 47(b) of the ICA, but Congress amended the statute after *TAMA* and deleted it. Reviewing the amended Section 47(b), the Court concluded that *TAMA* did not apply. The Court also considered the legislative history of the statute but found that the comments in the congressional reports addressing a right to sue could have been included in the statute, but were not.

Justice Ketanji Brown Jackson dissented, concluding that the majority misread the text and structure of Section 47(b). As to the text of the ICA, Justice Jackson opined that the 1980 amendment of Section 47(b) strengthened the language implying a private right of action because it added the words “rescission” and “at the instance of any party.” Justice Jackson commented that the plain meaning of the new language clearly provides that “any party” has the right to “rescind.” Justice Jackson further noted that the words “any party” probably meant a private party, not the SEC. Considering the structure of the ICA, Justice Jackson explained that the two private rights of action already in the ICA allow only the recovery of damages, not rescission as the amended language provides. Justice Jackson found in the legislative history that the congressional committee reports plainly stated the courts should imply private rights of action, and Justice Jackson criticized the majority for failing to accord them the appropriate weight.

Justice Sotomayor joined in Justice Jackson’s dissent, and Justice Kagan joined in parts of the dissent. Justice Kagan wrote that, in her view, the text, structure, and statutory history of Section 47(b) supports recognition of a private right of action, and she would not find it necessary to rely on the legislative history to support her conclusion.

The Court’s decision has broad implications for funds, investors, and the enforcement landscape of the ICA and other securities laws. Private ICA lawsuits are now restricted, so the burden of enforcing the ICA is foisted almost entirely on the SEC—an agency that lacks resources, information, and likely incentive to seek rescission of every contract that violates the ICA. But closed-end funds, with the probability of litigation markedly reduced, may enjoy increased stability and predictability in fund governance. Of course, activist investors may still pursue remedies in state court. The decision came as little surprise to most Court-watchers, and it signals that the Court is likely to continue the trend of declining to find implied private rights of action.

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