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Supreme Court to Decide Whether Section 47(b) Creates a Private Right of Action Under the Investment Company Act of 1940

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Overview

On December 10, 2025, the United States Supreme Court will hear arguments in *FS Credit Opportunities Corp. v. Saba Capital Master Fund, Ltd.* to resolve a circuit split and determine whether there is a private right of action for violations of the Investment Company Act of 1940, as amended (the "***1940 Act***"). The dispute concerns a shareholder of a registered investment company seeking to void bylaws adopted by the registered investment company's board, but the Court's ruling could have broad implications for other types of investment companies, including private funds and business development companies.

Section 47(b) of the 1940 Act provides:

"**(1)** A contract that is made, or whose performance involves, a violation of … [the 1940 Act]… is unenforceable by either party …

(2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny rescission at the instance of any party unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of [the 1940 Act]."[1]

Consistent with courts' general unwillingness to read private rights of action into statutes, courts, including the Third and Ninth Circuit Courts (as well as a panel of the Fourth Circuit, in an unpublished opinion), have historically declined to read implied private rights of action into the 1940 Act, including under Section 47(b). However, the Second Circuit in its 2019 decision, *Oxford University Bank v. Lansuppe Feeder, LLC*, for the first time recognized an implied private right of action under Section 47(b) for parties seeking to rescind contracts that violate the 1940 Act. In addition to considering these competing views, the Court is also likely to give significant consideration to its precedent in *Transamerica Mortgage Advisors, Inc. v. Lewis,* which recognized a limited private right of action for recission of contracts that violate the Investment Advisers Act of 1940, as amended, and its modern implied-rights jurisprudence, especially its 2001 decision in *Alexander v. Sandoval.*

Background on the Litigation

The case arises out of a challenge brought by a fund managed by Saba Capital Management L.P. ("***Saba Capital***"), a well-known investor that, among other strategies, has pursued an activist approach in certain closed-end funds, against several closed-end funds organized under Maryland law (the "***Maryland Funds***"). The Maryland Funds' boards adopted resolutions opting into provisions of the Maryland Control Share Acquisition Act ("***MCSAA***"), which restrict the voting rights of shareholders who cross specified ownership thresholds. Under the MCSAA, a shareholder acquiring sufficient shares to control at least 10% of voting power of a fund cannot vote those shares unless the other shareholders approve such voting rights by a two-thirds vote (the "***Control-Share Provisions***").

As Saba Capital accumulated shares, it sued the Maryland Funds, arguing that the Control-Share Provisions voting restrictions violate Section 18(i) of the 1940 Act, which requires that "every share of stock … shall be a voting stock and have equal voting rights with every other outstanding voting stock."[2] Saba Capital also asserted that, because fund bylaws are recognized as contracts under Maryland law, the Control-Share Provisions are unenforceable under Section 47(b) of the 1940 Act.

The Southern District of New York agreed with Saba Capital, holding that the Control-Share Provisions conflict with Section 18(i) of the 1940 Act, and that Saba could sue to void this provision, rather than relying on the Securities and Exchange Commission ("***SEC***") to bring a case. The Second Circuit affirmed. Although the lower courts' decisions focused on whether the adoption of the Control-Share Provisions violated Section 18(i), the question now before the Supreme Court is whether Section 47(b) provides shareholders with a private right of action to seek rescission of the performance of allegedly unlawful fund contracts.

Looking Ahead

The implications of the Court's ruling could be vast and depending on the outcome could greatly increase – or decrease – the ease with which private lawsuits could be brought relating to fund governance provisions in bylaws and operational agreements, funds' investment advisory relationships, funds' borrowing facilities with third parties and many other aspects of funds' day-to-day operations that are governed by contracts. Clarity on whether investors are able to sue for rescission of such contracts directly, especially in an era where the SEC leadership is pursuing an explicitly "deregulatory" approach, will impact the perceived legal risk associated with the contracts funds enter, as well as their engagement strategies with investors. Other contractual counterparties (such as lenders, trading counterparties, service providers and others) will also be closely watching this case, given its implications on the enforceability of contracts. Moreover, given the breadth of the 1940 Act, the impacts of the Court's ruling would not be limited to registered investment companies and would include business development companies (which are not the same as traditional registered investment companies, but are subject to different provisions of the 1940 Act) and private funds (which are excluded from the definition of investment company, but whose formation and operation could still implicate provisions of the 1940 Act that a private plaintiff could seek to enforce).

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[1] *See* 15 U.S.C. § 80a-46(b).

[2] In addition, Section 2(a)(42) of the 1940 Act defines a voting security to mean "any security ***presently*** entitling the owner or holder thereof to vote for the election of directors of a company" (emphasis added). The shares of an owner who had crossed the ownership threshold but had not obtained the requisite consent would arguably not be "voting stock."

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