No. 24-345

IN THE

Supreme Court of the United States

FS CREDIT OPPORTUNITIES CORP., *et al.*,

Petitioners,

v.

SABA CAPITAL MASTER FUND, LTD., *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF *AMICUS CURIAE* OF THE FREEDOM AND JUSTICE FOUNDATION IN SUPPORT OF NEITHER PARTY

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INTEREST OF THE *AMICUS CURIAE*[1]

The Freedom and Justice Foundation is a Section 501(c)(3) nonprofit corporation whose primary purpose is to promote and defend freedom and justice. In this case, justice requires the Court to look beyond the narrow question of whether the Investment Company Act of 1940 (the "ICA") creates a private right of action to seek rescission of a contract term that is alleged to violate the ICA because the right of a party to any contract to challenge its validity is a creature of common law that is incorporated in—not created by—the ICA.

SUMMARY OF ARGUMENT

The parties, other amici, and the lower courts have incorrectly assumed that if the ICA does not create a private right for a party to a contract to challenge a provision asserted to violate the ICA, that right does not exist. They all rely on the methodology outlined in *Alexander v. Sandoval*, 532 U.S. 275 (2001) to assess whether Congress intended to create that right. However, *Sandoval* is inapplicable here because Section 47(b) of the ICA simply affirms that the common law right of a party to offensively, or defensively, challenge a contractual provision that violates any statute applies to contracts that violate the ICA.

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1. No counsel for any party authored this brief in whole or in part, and no person other than Amicus Curiae made a monetary contribution to its preparation or submission.

ARGUMENT

I. *SANDOVAL*'S METHODOLOGY IS NOT APPLICABLE TO CONTRACTUAL DISPUTES BETWEEN PRIVATE PARTIES.

A private right of action authorizes persons that have been harmed by an alleged violation of a statute to sue the alleged lawbreaker. In *Alexander v. Sandoval*, 532 U.S. 275 (2001) and its progeny, this Court provided guidance to determine if Congress intended to create a private right of action to enforce a federal law. *Sandoval* was a class action challenge to a state policy alleged to violate the disparate-impact regulations promulgated under Title VI of the Civil Rights Act of 1964. This Court determined that Congress did not intend to authorize private parties to enforce Title VI. That is a very different matter than determining if a party to a contract that allegedly violates Title VI (or any statutory provision) has a right to seek rescission of that contract.

The phrase, "It shall be unlawful" appears sixty times in the ICA. For example, § 20(b) of the ICA reads: "It shall be unlawful…for any registered investment company (a "RIC") to distribute long-term capital gains…more often than once every twelve months." Applying *Sandoval*'s methodology, there is nothing to indicate that Congress intended to authorize a stockholder of a RIC that makes more than one such distribution within a twelve-month period to sue the RIC or its directors to enforce § 20(b) of the ICA. But § 47 does not prescribe or proscribe anything. It merely states that a contract that violates the ICA is void and unenforceable and specifies the judicial remedy for such a contract. Therefore, no one (including

the SEC) can be said to "enforce" § 47. Consequently, the *Sandoval* methodology is not appropriate to determine whether a party to a contract can ask a court to declare that a provision of the contract violates the ICA and, if so, to order the defendant to rescind it.[2]

II. UNDER COMMON LAW, A PARTY TO A CONTRACT THAT ALLEGEDLY VIOLATES ANY LAW MAY SUE TO INVALIDATE IT.

Contracts, and contractual disputes, have existed for thousands of years. The bylaws of a corporation are deemed to constitute a contract, specifically a contract among the stockholders and the corporation itself.[3] A contract term that violates any statute is void and unenforceable under common law. Moreover, the Declaratory Judgment Act, 28 U.S.C. §§ 2201–2202 (the "DJA") authorizes a party to a contract to sue for a declaration to that effect. The Respondent, a stockholder of each Petitioner fund, claimed

2. Caution in applying *Sandoval*'s methodology here is warranted for another reason. Unlike other federal statutes, Section 1 of the ICA directs courts to interpret its provisions "to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors." One such condition is "when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities." Allowing a contractual term that violates a provision of the ICA to remain in force is difficult to square with Section 1's interpretive mandate.

3. *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010). ("Corporate charters and bylaws are contracts among a corporation's shareholders.")

that each had adopted an "control share" bylaw that violates the ICA's "one share—one vote" requirement. 15 U.S.C. § 80a–18(i) ("[E]very share of stock ... shall be a voting stock and shall have equal voting rights" with every outstanding stock.") The courts below agreed and so declared.

III. SECTION 47 INCORPORATES COMMON LAW PRINCIPLES AND AFFIRMS THAT THEY APPLY TO CONTRACTS THAT VIOLATE THE ICA.

In other contexts, the Court has held that "Congress's failure to displace firmly rooted common-law principles generally indicates that it incorporated those established principles into [a federal statute.]" See *Health and Hospital Corporation of Marion City v. Talevski*, 599 U.S. 166, citing *Wyatt v. Cole*, 504 U.S. 158 (1992) at 163–164. Section 47 of the ICA, entitled "Validity of Contracts," is not just silent concerning common law principles relating to contracts; it expressly and unambiguously incorporates them and affirms that they apply to contracts that violate the ICA. It reads as follows:

> (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of *this title* or with any rule, regulation, or order thereunder shall be void.
>
> (b)(1) A contract that is made, or whose performance involves, a violation of *this title*, or of any rule, regulation, or order there under, is unenforceable by either party (or by a nonparty to the contract who acquired a right under the contract with knowledge of the facts by reason

> of which the making or performance violated or would violate any provision of *this title* or of any rule, regulation, or order thereunder) unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of *this title*.
>
> (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 *this title*.
>
> (3) This subsection shall not apply (A) to the lawful portion of a contract to the extent that it may be severed from the unlawful portion of the contract, or (B) to preclude recovery against any person for unjust enrichment. (Emphasis supplied.)

The Restatement (Second) of Contracts § 178 (1981), entitled "Unenforceability on Grounds of Public Policy—When a Term Is Unenforceable on Grounds of Public Policy," reads as follows:

> (1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a

public policy against the enforcement of such terms.

(2) In weighing the interest in the enforcement of a term, account is taken of

(a) the parties' justified expectations,

(b) any forfeiture that would result if enforcement were denied, and

(c) any special public interest in the enforcement of the particular term.

(3) In weighing a public policy against enforcement of a term, account is taken of

(a) the strength of that policy is manifested by legislation or judicial Decisions

(b) the likelihood that a refusal to enforce the term will further that policy,

(c) the seriousness of any misconduct involved and the extent to which it was deliberate, and

(d) the directness of the connection between that misconduct and the term.

By substituting "any statute" or "such statute" for "this title" in § 47, it is plain that it is on all fours with common law principles concerning contract terms that are contrary to public policy as expressed in legislation.

Indeed, Congressional reports note that § 47 "contains the *usual* provisions regarding of validity of contracts…." S. Rep. No. 76-1775, at 20; see H.R. Rep. No. 76-2639, at 25. (Emphasis supplied.) Consequently, the best reading of § 47 is as an affirmation that the same common law, i.e., "usual," principles and causes of action that apply to contracts that violate other statutes apply to contracts that violate the ICA.

IV. IN ADOPTING § 47(b), CONGRESS ANTICIPATED DECLARATORY JUDGMENT ACTIONS BY PARTIES TO CONTRACTS.

By adopting § 47(b), Congress not only affirmed the common law right of private parties to challenge the validity of contractual terms alleged to violate the ICA, it anticipated declaratory actions to do so. Congress adopted the DJA in 1934, just six years before it adopted the ICA. In relevant part, the DJA reads: "In a case of actual controversy within its jurisdiction, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such." 28 U.S.C. § 2201(a). In *The Federal Declaratory Judgments Act*, 21 Va. L. Rev. 35 (1934), Edward Borchard explained a primary benefit of the DJA:

> Under declaratory procedure [a] contract can be construed…before a party has acted upon his own assumption as to his rights. As Congressman Gilbert expressed it in a much

> quoted remark in the House of Representatives on January 25, 1928: "Under the present law you take a step in the dark and then turn on the light to see if you stepped into a hole. Under the declaratory judgments law, you turn on the light and then take the step."

Three years after adoption of the DJA, this Court upheld its constitutionality in a case to determine the rights and obligations of the parties to a life insurance contract. *Aetna Life Ins. Co.* v. *Haworth,* 300 U.S. 227 (1937). Therefore, in wording § 47(b), the 1940 Congress almost certainly anticipated private lawsuits seeking a declaration that a contract violates the ICA.

V. SECTION 47(b) DOES NOT "CREATE" A PRIVATE CAUSE OF ACTION; IT AFFIRMS IT.

Each of the Second, Third, Fourth, and Ninth Circuit Courts of Appeal applied the methodology established in *Sandoval* to determine whether Congress intended to "create" a private cause of action in § 47. Since the common law right to seek a court order invalidating a contract predates the ICA, the latter three courts were technically correct in holding that § 47 does not "create" a (new) private right of action and the Second Circuit was incorrect in holding that § 47 does "create" a private right of action. Yet, only the Second Circuit, in *Oxford University Bank v. Lansuppe Feeder, LLC*, 933 F.3d 99, 108 (2d Cir. 2019), acknowledged the elephant in the courtroom: "None of [the contrary prior] opinions explain what effect § 47(b)(2) has if it does not provide a private right of action." Unfortunately, the *Oxford University*

Bank panel succumbed to the false dilemma fallacy.[4] That is, it incorrectly assumed it had only two choices and concluded that § 47(b)(2) must "create" a private right of action lest it be "effectively read… out of the ICA." *Id.*[5]

The Petitioners and their amici also fall prey to the false dilemma fallacy in straining to respond to the Second Circuit's concern about the purpose of § 47. They posit that § 47 only authorizes "the defendant in a breach-of-contract suit [to] invoke Section 47(b)(1) defensively to argue that the contract is unenforceable because it violates the ICA." *Brief for the United States as amicus curiae in support of petition for writ of certiorari*. While that brief admits that § 47 "tracks the common law," it leaps to the unwarranted conclusion that § 47 "contemplates an ongoing court proceeding between private parties." *id*. But it offers no reason Congress would seek to bar a party to an unlawful contract from seeking declaratory relief instead of waiting to be sued. This Court has stated that "when Congress wished to provide a private remedy [to enforce a statutory provision], it knew how to do so and did so expressly." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 572 (1979). Congress also knew how to prohibit the offensive use of litigation by parties to contracts that violate the ICA but nothing in § 47 suggests an intent to do so. Moreover, a defendant in a breach-of-contract lawsuit need not rely on § 47 because, under common law,

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4. A false dilemma is a logical fallacy where only two choices are seen as possible when more options exist. This creates a misleading impression that one of the options presented must be chosen.

5. That is no mere theoretical concern. To our knowledge, the SEC has never brought an enforcement action relating to § 47.

a contract that violates *any* statute is unenforceable. In fact, if § 47 did not exist, a party to a contract that violates the ICA would have a common law right to ask a court to invalidate it either as a plaintiff or a defendant. Nothing in § 47 undermines that right.

As explained above, in adopting § 47(b)(2), Congress sought to affirm the common law right of parties to sue to invalidate contracts that violate the ICA—not, as the Second Circuit concluded, to "create" a new right. Therefore, the Third, Fourth, and Fifth Circuits were technically correct to hold that § 47 does not "create" a private right of action.[6] But they too failed to consider common law as a possible source for that right.

VI. PROHIBITING LAWSUITS BY PARTIES TO CONTRACTS THAT VIOLATE THE ICA COULD LEAD TO ABSURD RESULTS.

Lawsuits challenging a bylaw alleged to contravene state corporation statutes are routinely brought under common law. For example, in *Solak v. Sarowitz*, 2016 WL 7468070 (Del. Ch. Dec. 27, 2016), a stockholder of a corporation sought a declaration that a fee shifting bylaw violated a provision of the Delaware General Corporation

6. Unlike the Respondents, no plaintiff in any of these cases, *Santomenno ex rel. John Hancock Trust v. John Hancock Life Ins. Co.*, 677 F.3d 178 (3d Cir.), *Steinberg v. Janus Capital Mgmt., LLC*, 457 Fed. Appx. 261 (2011), or *UFCW Local 1500 Pension Fund v. Mayer*, 895 F.3d 695 (2018), was a party to an allegedly illegal contract. Rather, they were third party beneficiaries or sued in a derivative capacity on behalf of an actual party to a contract. As such, it is "contestable" whether they have a common law right to sue. *Talevski*, 599 U.S. 166.

Law (the "DGCL") prohibiting any bylaw that purports to shift a corporation's litigation expenses to a stockholder in connection with an internal corporate claim. The Court found the stockholder's facial challenge ripe for review because the bylaw "otherwise may never be subject to judicial review given its deterrent effect." *Id.*

The same deterrent effect would exist if a stockholder sued a Delaware RIC for a declaration that (1) one bylaw of the RIC is void because it violates the DGCL, and (2) another bylaw is void because it violates the ICA. It would be absurd for a court to allow the former claim but disallow the latter claim. That illustrates why the right of a stockholder to seek a declaration that a bylaw is void if it violates *any* statute is not a creation of Congress or of federal law. Rather, a party to any contract has an inherent right under common law to challenge its validity and it is inconceivable that Congress sought to eliminate that right for contracts that violate the ICA.

CONCLUSION

Section 47 of the ICA does not prescribe or proscribe anything. Hence, the *Sandoval* methodology is not appropriate to determine whether a party to a contract can ask a court to determine if a provision in the contract violates the ICA and, if so, to order the defendant to rescind it. Section 47(b) does not "create" any right. With apologies to the writers of a classic country song[7] from Urban Cowboy, the lower courts have been looking for rights in all the wrong places. A party to *any* contract has a common law right to challenge its validity, offensively or defensively, if it is alleged to contain a provision that contravenes *any* statute. For that reason, the Court should hold that § 47(b) incorporates that right and affirms that it applies to contracts that violate the ICA.

Respectfully submitted,

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7. "Looking for Love in All the Wrong Places" by Wanda Mallette, Bob Morrison, and Patti Ryan (1980).