

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 OF SECURITIES-LAW SCHOLARS AND
FORMER SENIOR SEC OFFICIALS AS AMICI
CURIAE IN SUPPORT OF RESPONDENTS**

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INTEREST OF AMICI¹

Amici are prominent corporate and securities law scholars as well as former senior officials of the U.S. Securities and Exchange Commission (SEC). Collectively, they have decades of experience in teaching, studying, administering and enforcing the federal securities laws. Signatories include:

- Lucian A. Bebchuk, James Barr Ames Professor of Law, Economics, and Finance and the Director of the Program on Corporate Governance at Harvard Law School. The Social Science Research Network (SSRN) ranks Bebchuk as among the two top legal academics in all fields in terms of citations to his work.
- Matthew Cain, who served as an Advisor to an SEC Commissioner and previously as a financial economist at the SEC. Dr. Cain currently is a Senior Fellow at the New York University School of Law.
- Quinn D. Curtis, Associate Dean and Professor of Law at the University of Virginia School of Law. Professor Curtis has written extensively on the regulation of mutual funds and retirement accounts, including empirical work on 401(k) plans, mutual fund governance and fee litigation, and he is a board member of the Society for Empirical Legal Studies.
- Parveen P. Gupta, who served in the SEC's Division of Corporate Finance from 2006 to

¹ No counsel for a party authored this brief in whole or in part. No party or counsel for a party made a monetary contribution intended to fund the preparation or submission of this brief, and no person other than *amici* or its counsel made such a contribution.

2007. He is currently the Clayton Distinguished Professor of Accounting at Lehigh University and has served on the Investor Advisory Group of the Public Company Accounting Oversight Board.

- Thomas Lee Hazen, Cary C. Boshamer Distinguished Professor of Law at the University of North Carolina School of Law. Professor Hazen, a recognized expert in the fields of securities, commodities, and corporate law, is the author of a seven-volume treatise, *Securities Regulation*, and has authored a monograph on securities law that was commissioned by the Federal Judicial Center.
- Edwin Hu, Associate Professor of Law at the University of Virginia School of Law. Dr. Hu previously served as an economist to an SEC Commissioner and in the SEC's Division of Economic and Risk Analysis.
- Henry T.C. Hu, Allan Shivers Chair in the Law of Banking and Finance at the University of Texas at Austin School of Law. From 2009 to 2011, Professor Hu served as the founding Director of the SEC's Division of Economic and Risk Analysis, the first newly created SEC Division in thirty-seven years.
- Robert Jackson, who was nominated in 2017 by President Donald J. Trump and unanimously confirmed by the U.S. Senate to serve as an SEC Commissioner, a role he held until 2020. He is now Nathalie P. Urry Professor of Law and Co-Director of the Institute for Corporate Governance and Finance at the New York University School of Law.

- Renee Jones, Professor and Dr. Thomas F. Carney Distinguished Scholar at Boston College Law School. Professor Jones previously served as Director of the SEC's Division of Corporation Finance, leading a team of more than four hundred SEC lawyers, accountants and analysts charged with interpreting, implementing and ensuring compliance with the federal securities laws.
- Reinier Kraakman, Ezra Ripley Thayer Professor of Law at Harvard Law School. Professor Kraakman has been an advisor on company law reform in Russia and Vietnam, is lead author of the treatise *The Anatomy of Corporate Law: A Comparative and Functional Approach* and co-author of the textbook *Cases and Commentaries on the Law of Business Organization*, and served as a law clerk to Judge Henry J. Friendly of the U.S. Court of Appeals for the Second Circuit.
- Donald Langevoort, Thomas Aquinas Professor of Law at Georgetown Law. Professor Langevoort is the co-author of *Securities Regulation: Cases and Materials*, has testified numerous times before Congressional committees on issues relating to insider trading and securities litigation reform, and previously served at the SEC as Special Counsel to its Office of General Counsel.
- Allison Herren Lee, who served as an SEC Commissioner from 2019 to 2022 and as Acting Chair in 2021. Previously, she served for over a decade in various roles at the SEC, including as Counsel to a Commissioner and as a Senior Counsel in the Division of Enforcement's Complex Financial Instruments Unit.

- John Morley, Augustus E. Lines Professor of Law at Yale Law School. Professor Morley is a leading expert on the regulation and structure of investment funds, including mutual funds, private equity funds and hedge funds.
- Jonathon Zytnick, Associate Professor of Law at Georgetown Law. Dr. Zytnick, whose work has appeared in the *Journal of Financial Economics* and the *American Law and Economics Review*, previously served as Counsel to an SEC Commissioner and a law clerk on the United States Court of Federal Claims.²

Cognizant that the Court’s task is “to determine whether [the statute] displays an intent to create not just a private right but also a private remedy,” and that “[s]tatutory intent on this latter point is determinative,” *Alexander v. Sandoval*, 532 U.S. 275, 286 (2001), amici write to describe the state-level securities laws Congress drew from when drafting the text of Section 47(b) of the Investment Company Act (ICA), the longstanding congressional recognition that that language creates a private right to rescission, and the economic reasons why a contrary holding would undermine compliance with the ICA.

SUMMARY OF ARGUMENT

The Congress that wrote the original text of Section 47(b) was not writing on a blank slate. Instead, Section 47(b)’s original language mirrored widespread “voidness” provisions in the Nation’s earliest state securities laws—provisions that were widely understood to

² The views expressed by *amici* do not necessarily reflect the views of the institutions with which they are or were associated. Those institutions are included solely for identification purposes.

confer a right to rescission.³ Those state “blue sky” laws⁴ and the federal securities statutes that drew on them—such as Section 47(b)’s federal precursor, Section 29(b) of the Securities Exchange Act—reflected lawmakers’ judgment that private rights to rescind contracts that violate securities law can be an efficient means of policing compliance. Later amendments to the text of both Exchange Act Section 29(b) and ICA Section 47(b) leave little doubt that the text Congress chose created a private right to rescission, which is why learned securities scholars have for so long described rights of action under these statutes as “more express than implied.” 3 Louis Loss, *Securities Regulation* 1759 (2d ed. 1961) (referring to Exchange Act Section 29(b)).

And lawmakers’ century-old judgment that private rights of rescission efficiently aid compliance with state and federal securities laws makes economic sense. Securities regulators at both the state and federal levels lack the resources and information necessary to pursue rescission of agreements that violate their organic statutes—which is why both state and federal securities law have provided private rights to rescind those agreements for so long.

³ See, e.g., Note, *Validity of Contracts Which Violate Regulatory Statutes*, 50 YALE L.J. 1108, 1113 (1941) (the year after the ICA’s passage, describing statutes “which provide that ‘every contract made in violation of any provision of this title ... shall be void,’ and noting the prevailing view that “when they do, the word ‘void’ will be interpreted to mean ‘subject to rescission’”).

⁴ State securities laws are often called “blue sky” laws because, as Justice McKenna explained for the Court in 1917, “the evil at which” these laws were “aimed” was “speculative schemes which have no more basis than so many feet of ‘blue sky,’” *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917).

ARGUMENT

I. IN HISTORICAL CONTEXT, THE ORIGINAL AND AMENDED TEXT OF SECTION 47 REFLECT CONGRESS'S INTENT TO CREATE A PRIVATE RIGHT TO RESCISSION.

As originally adopted in 1940, Section 47(b) of the ICA provided that “[e]very contract made in violation of” the ICA “shall be void” “as regards the rights of any person who” “shall have made ... any such contract.” 54 Stat. 846 (1940). That text mirrored both Exchange Act Section 29(b), which Congress had amended just two years before, and state blue sky laws long understood to create a private right to rescission.

As Judge Leval has explained, subsequent amendments to Section 47(b) leave little doubt that Congress understood both the text it had chosen in 1940 and in the amendments to create a private right to rescission. *Oxford Univ. Bank v. Lansuppe Feeder, LLC*, 933 F.3d 99, 107 (2d Cir. 2019). Viewed in the historical context in which state and federal securities-law statutes were developed, those amendments, like subsequent changes to Section 29(b), simply specify the circumstances under which relief may be granted.

A. Rights to Rescission under Voidness Provisions in State Blue Sky Laws.

Long before Congress adopted the principal federal securities laws, a “majority of” “state [securities-law] statutes” “specifically include[d] some sort of provision to the effect that” “contracts in violation shall be ‘void or ‘voidable.’” Louis Loss, *Securities Regulation* 962 (1952). In the years prior to the Depression, those provisions produced a legion of state-court opinions relating to their application.

Those opinions reflect both a consensus that these provisions created a private right to rescission and the heritage of that right.⁵ The Supreme Court of New Hampshire, for example, writing in 1922 to address “the rights of the parties under a contract . . . made in violation” of New Hampshire’s securities law, quoted Lord Mansfield to explain that, “where contracts ... are prohibited by positive statutes,” “in furtherance of these statutes, the person injured, after the transaction is finished and completed, may bring his action to defeat the contract.” *Karamanou v. H.V. Greene Co.*, 124 A. 373, 374 (1922) (cleaned up) (quoting *Browning v. Morris*, 2 Cowp. 790, 792 (1778)).⁶

That right, of course, had limits. In the vast majority of state blue sky laws, the word “violation” “refer[red] broadly to any violation of the act.” Louis Loss, *Blue Sky Law* 131 (1958). Courts interpreted that broad language to mean that such contracts were voidable in a court’s discretion, not void *ab initio*. That interpretation guarded against absurd results. Were it otherwise, a buyer, after years of receiving dividends on stock purchased under such a contract, could seek her original purchase price back. *E.g.*, *Cummings v.*

⁵ Commenters collecting blue sky laws have referred to voidness provisions as “[o]ne of the most common” sources of civil liability in state securities law. Robert L. Matia, *Express and Implied Civil Liability Provisions in State Blue Sky Laws*, 17 CASE WESTERN RES. L. REV. 1173 (1966). And it has long been said that blue sky “voidability provisions” are an “[e]xpress,” rather than implied, source of civil liability. *Id.*

⁶ Moreover, these voidness provisions were widely understood to be both defensive *and* offensive. Courts made clear that these provisions could be “pleaded” “as against the plaintiff’s right to recover” or as an “affirmative action[] ... instituted for the purpose of rescinding the prohibited agreements.” *Tomberlin v. Waycross Com. Hotel Co.*, 152 S.E. 300, 302 (Ga. Ct. App. 1930).

Hotchkiss Co., 197 N.E. 473, 475 (Mass. 1935). And instruments issued under contracts that violated state securities law—because, say, they were not registered as required—that had “subsequently passe[d] to a bona fide purchaser for value” were “held, virtually without exception,” to allow the “holder in due course . . . [to] recover on [the instrument] despite the defect of illegality.” Loss, *Blue Sky Law*, *supra*, at 132.

The Depression-era scholars who framed federal securities law chose not to include a broad voidness provision in the first statute they drafted, the Securities Act of 1933.⁷ But the next year, Congress chose to draw on states’ blue sky experience when adopting the Securities Exchange Act of 1934.

B. Congress’s Adoption of Voidness Text in Exchange Act Section 29 and ICA Section 47 Demonstrate Intent to Create a Right to Rescission.

When Congress undertook comprehensive securities regulation, “it explicitly drew from” states’ “experience” and “enactment of their own ‘blue-sky’ statutes.” *Aaron v. SEC*, 446 U.S. 680, 711 (1980) (Blackmun, J., concurring in part). Congress chose to draw on states’ blue sky provisions when adopting Section 29 of the Exchange Act, on which Section 47(b) has long been understood to have been “modeled.” Louis Loss, *Securities Regulation* 1786 (1983). Section 29’s original text provided:

⁷ Among them was then-Yale Law School Professor William Douglas, *see* William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171 (1933), who served as the third Chairman of the SEC before serving on this Court. HENRY J. ABRAHAM, *JUSTICES AND PRESIDENTS: A POLITICAL HISTORY OF APPOINTMENTS TO THE SUPREME COURT* (1992).

Validity of Contracts.—

(b) Every contract made in violation of any provision of this title ... shall be void (1) as regards the rights of any person who ... shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of [this title].

48 Stat. 903 (1934).

Like the voidness provisions in state blue sky laws, the text of Section 29(b) has been widely understood, virtually since its passage, to confer a private right to rescission. *See generally* Samuel H. Gruenbaum & Marc I. Steinberg, *Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 Geo. Wash. L. Rev. 1 (1979). Indeed, this Court explained fifty years ago that Section 29(b), “which has counterparts in ... the [ICA],” *viz.*, Section 47(b), gives “the victim” of a securities violation “the right to rescind” the offending contract. *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 387-88 (1970).

Notice, too, that in Section 29(b)’s original text Congress addressed one of the ambiguities present in state blue sky statutes: whether rescission should be available in cases involving instruments issued under “void” contracts subsequent acquired by a bona fide purchaser for value. Congress addressed this concern by making rescission available against only such purchasers who had “actual knowledge of the facts by reason of which” the “contract was in violation” of law.

Four years after the Exchange Act became law, Congress amended Section 29(b) in telling fashion. Without altering the original text, in amendments to Section 29(b) adopted in 1938, Congress added:

Provided, (A) That no contract shall be void by reason of this subsection because of any violation of [certain broker-related provisions] of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance of this subsection, [in certain cases], unless such action is brought within one year after the discovery [of certain facts] and within three years after [a] violation [of certain provisions].

52 Stat. 1076 (1938).

We offer two observations about that text, which added a statute of limitations to certain actions brought under Section 29(b). First, as SEC Commissioner Richard B. Smith explained:

Congress obviously did not add a statute of limitations to apply to a right of action that did not exist[. So federal courts] drew the obvious conclusion that “[t]he 1938 amendment to Section 29(b) clearly contemplates that a [private] civil suit may be brought.”⁸

Second, Congress in 1938 did not think it necessary to change Section 29(b)’s original prefatory language providing that contracts “shall be void” “as regards the

⁸ U.S. Sec. & Exch. Comm’n, Commissioner Richard B. Smith, *The Interest of the SEC in Private Civil Actions Under the Securities Acts* (remarks to the State Bar of California, Los Angeles, January 1968) (quoting *Geismar v. Bond & Goodwin*, 40 F. Supp. 876, 878 (S.D.N.Y. 1941) (Coxe, J.)).

rights” of “any person” in order for courts to reach the “obvious conclusion” that the statute created a private right to a rescission remedy. Rather, Congress was comfortable that that language, standing alone, was adequate to create the cause of action that its amendments limited in time.

Two years later,⁹ Congress¹⁰ chose language for ICA Section 47(b) essentially identical to that used in Exchange Act Section 29(b).¹¹ As originally adopted, ICA Section 47(b) provided:

⁹ The ICA was adopted after the “market crash of 1929 exposed a range of practices that damaged the public reputation of closed-end funds [(CEFs)] for years afterward.” John Morley, *Collective Branding and the Origins of Investment Fund Regulation*, 6 VA. L. & BUS. REV. 341, 353 (2014). “The primary difference between ‘mutual funds’ and ‘closed-end funds,’ like Petitioner, ‘is that mutual funds allow shareholders to redeem their shares in exchange for cash, while closed-end funds do not.’” *Id.* at 348.

¹⁰ The ICA was developed in close collaboration between Congress and the SEC; indeed, it was SEC-proposed legislation that eventually became the ICA. The SEC’s proposal, in turn, reflected a study, mandated by Section 30 of the Public Utility Holding Company Act and overseen by SEC Commissioner Robert Healy, of the investment company industry. SECURITIES AND EXCHANGE COMM’N HISTORICAL SOCIETY, INVESTMENT COMPANY REGULATION: THE INTRICACIES OF AN “ENLIGHTED PARTNERSHIP” (citing U.S. Sec. & Exch. Comm’n, *Study on Investment Trusts and Companies* (1940)) (noting that the study included “33,000 pages of transcripts, 4,800 exhibits, and a multi-volume report,” and that its most “striking finding was its assessment of the damage”: “[a]ll told U.S. investors had lost about \$3 billion of a total \$7 billion investment” in certain investment vehicles).

¹¹ Among the remarkable aspects of the ICA’s history is that it was adopted as Congress contemplated World War II; “Dunkirk was being evacuated on May 31 when the second round of Senate hearings [related to the ICA] began, and the House hearings ended on June 14, the day Germany occupied Paris. The only

Validity of Contracts.—

Every contract made in violation of any provision of this title ... shall be void (1) as regards the rights of any person who ... shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of [this title].

54 Stat. 845-46 (1940).

C. Subsequent Legal Developments Reflect the 1940 Congress’s Intent to Create a Private Right to Rescission.

Three developments since 1940 have left no doubt that Congress has always understood that Section 47(b) confers a private right to rescission.¹²

reason Congress was still meeting” when the ICA was adopted “was that the Congressional session had been extended indefinitely to prepare for war.” Morley, *supra* note 9, at 365.

¹² The Government’s certiorari-stage concession that the original text of Section 47(b) “authorized private suits,” Br. For the U.S. as Amicus Curiae in Support of Granting the Petition, at 15, is difficult to square with its merits-stage refusal to take a position on whether Section 47(a), which to this day uses the word “void,” “confer[s] private right[s] under the reasoning of *TAMA*,” U.S.Br. at 31. *TAMA* correctly and carefully analyzed similar text; if the Government thinks *TAMA* incorrectly decided, it should say so. In any event, the Government’s concession, if accepted, leaves petitioners with the sole contention that the 1980 amendments to Section 47(b) somehow stripped a private right to rescission under the ICA while leaving the same right in place in the IAA and Exchange Act Section 29(b), and leaving untouched

First, in 1979 this Court’s decision in *Transamerica Mortg. Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979) (TAMA) considered similar text in Section 215 of the Investment Advisers Act (IAA) and found that the “statutory language itself fairly implies a right” to rescission “[b]y declaring certain contracts void.” *Id.* at 18. “At the very least,” the Court explained, “Congress must have assumed that § 215 could be raised defensively in private litigation,” “[b]ut the legal consequences of voidness are typically not so limited”: “[a] person with the power to void a contract ordinarily may resort to a court to have the contract rescinded.” *Id.* Citing Exchange Act Section 29 as an example, the Court “conclude[d] that when Congress declared in § 215 that certain contracts are void, it intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission.” *Id.*

Second, as Judge Leval has explained, Congress responded to TAMA “in a manner that strongly implied that it endorsed the result” this Court had reached. *Oxford*, 933 F.3d at 107. The amendments specified that a “contract that ... involves a violation of this title ... is unenforceable by either party” “unless a court finds that under the circumstances enforcement would produce a more equitable result” and that, if such a contract 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.” Small Business

the prefatory phrase “Validity of Contracts” and the word “void” in Section 47(a). Nothing in the amendments’ text suggests that Congress thought it was taking such a significant step, and the legislative history makes that interpretation implausible.

Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2277 (Oct. 21, 1980).

The amendments' text cannot be squared with the readings of Section 47 advanced by petitioners and their *amici*—contending, for example, that the language permits civil actions to be brought only by the SEC. *See, e.g.*, Pet.Br. 32-35. For one thing, the amendments refer repeatedly to claims brought by “any party,” and as the Second Circuit noted, it is “highly unlikely that Congress meant to allow a suit only by the SEC when it used a phrase that so unambiguously contemplates that more than one entity may seek rescission.” *Oxford*, 933 F.3d at 105-06. For another, when adopting the amendments Congress made clear that it understood Section 47(b) to confer a private right to rescission. Indeed, the relevant House Committee Report noted that in recent years the Supreme Court had:

turned its focus toward a strict construction of statutory language and expressed intent[, such as in *TAMA*], [where t]he Court would not imply a private cause of action for damages

The Committee wishes to make plain that it expects the courts to imply private rights of action under this legislation, where the plaintiff falls within the class of persons protected by the statutory provision in question. Such a right would be consistent with and further Congress's intent in enacting that provision

H.R. Rep. No. 96-1341, 96th Cong., 2d Sess., at 29 (1980).

Finally, the SEC responded to these events in 2001 by taking the view that, since the “reasoning” of *TAMA* “applies equally to Section 47(b),” “the remedy [of rescission] under the current version of Section 47(b) should be viewed as an express rather than an implied one.” SEC.Br. at 12, *Olmstead v. Pruco Life Ins. Co. of N.J.* (2d Cir. 2002). “Moreover,” the SEC explained, “Congress was aware of [*TAMA*] at the time it amended [Section 47(b)] in 1980,” and “given the explicit language in [the amended] Section 47(b)(2) that creates a presumption in favor of rescission,” the statutory text clearly provided a private right to that remedy. *Id.* at 13.¹³

* * * *

The original text of Section 47(b) was drawn from Exchange Act Section 29(b) at a time when the language of the latter provision had just been amended to make it “obvious,” in the view of both courts and SEC Commissioners, that the text conferred a private right

¹³ Apparently the “SEC has since reconsidered its view of Section 47(b) in light of this Court’s more recent guidance on implied private rights to enforce federal law.” U.S.Br. at 12 n.2. But the SEC’s carefully reasoned *Olmstead* brief was filed months after this Court decided *Sandoval*, and in any event the Commission’s repeated conclusion in *Olmstead* was that the right to rescission in Section 47(b) was “express,” not implied, SEC.Br., *Olmstead*, *supra*, 2001 WL 34113763, at *2, *12, *24, making the SEC’s unreasoned change in position puzzling. Since “the weight due [federal-agency interpretations] must always ‘depend on their thoroughness . . . , the validity of [their] reasoning, [their] consistency with earlier and later pronouncements, and all those factors which give them power to persuade,’” *Loper Bright Enter. v. Raimondo*, 603 U.S. 369, 388 (2024) (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)); *see also id.* at 431-32 (Gorsuch, J., concurring) (same), the SEC’s unexplained change of position in this case deserves little weight.

to rescission. Both statutes' text mirrored state securities laws that had long used that language to confer a private right to rescission. And when Congress amended Section 47(b), it did so in a fashion that adopted this Court's conclusion in *TAMA* that the text created a private right to rescission. Accordingly, Section 47(b) presents one of the "cases in which, [even] without an express statutory statement concerning private actions, it remains possible to draw [solely] from the text and history of the statute inferences of congressional intent"; in such cases, like this one, all that is required is "conventional statutory interpretation." Note, *Implying Civil Remedies from Federal Regulatory Statutes*, 77 Harv. L. Rev. 285, 289-90 (1963).

**II. ECONOMIC ANALYSIS SUPPORTS
LAWMAKERS' JUDGMENT THAT PRIVATE
RIGHTS TO RESCISSION OF CONTRACTS
THAT VIOLATE SECURITIES LAW CAN
BENEFIT INVESTORS.**

Petitioners and their amici contend, as an economic matter, that "centralized" enforcement of Section 47(b) by the SEC alone would be superior to enforcement by both the agency and through private rights to rescission. Pet.Br. 38-41; *e.g.*, Chamber of Commerce Br. 20-23. As explained in Part I, *supra*, that view conflicts with the policy judgment of dozens of state legislatures and Congress which, in 1934 and 1938 (as to Exchange Act Section 29(b)) and again in 1940 and 1980 (as to ICA Section 47(b)) disagreed. That alone is reason enough to reject petitioners' policy view.¹⁴ But,

¹⁴ To be sure, this Court has left no doubt that statutory text, rather than economic analysis of the choices legislators have made, is determinative in matters of interpretation. *Sandoval*,

as explained below, that view is also incorrect as a matter of economic analysis of law.

As an economic matter, lawmakers' judgment about the benefits of private rights to rescission of contracts that violate securities law makes sense. Both state and federal governments lack the information and resources necessary to pursue rescission of contracts that violate securities law. And in closed-end funds particularly, where shareholders cannot exit the fund at a price that fully reflects the value of its assets, a private right to rescission is a rare mechanism allowing investors to respond to fund mismanagement.

A. Private Rights to Rescission Can be a Desirable Supplement to Centralized Securities-law Enforcement Facing Limited Resources and Information.

From the earliest blue sky statutes, legislators worried that state-level securities regulators lacked resources necessary to seek rescission of contracts violating state law. When those statutes were adopted, “[e]xcept for a very few states, the blue sky offices [were] far too small and too loosely organized to allow a full administration of the statutes.” Loss, *Blue Sky Law*, *supra*, at 57, 130. Those offices had inadequate budgets and a “lack of administrative procedures to effect rescission[, making private] civil liability an appealing alternative” to public enforcement. Dale C. LaPorte, *Voidability Provisions under State Blue Sky Laws*, 17 Case W. Res. L. Rev. 1148 (1996).

Thus, it was well understood at “the state level” that the government’s resource constraints “ma[d]e civil

532 U.S. at 287-88. We merely offer this analysis in response to policy arguments advanced by petitioner and its amici.

liability a *sine qua non* in the blue sky laws.” Loss, Blue Sky Law, *supra*, at 130. And “[e]ven at the federal level, where there is a substantial enforcement agency, Congress relied heavily on civil liability as a sanction.” *Id.* Indeed, the House Report accompanying the 1980 amendments to the ICA noted that “Congress has long taken the view that private rights of action for violations of the federal securities laws are a necessary adjunct to the [SEC’s] enforcement efforts.” H.R. Rep. No. 1341, 96th Cong., 2d Sess., at 28. As SEC officials have acknowledged, that is “[b]ecause the Commission does not have adequate resources to detect and prosecute all violations of the federal securities laws,” such that “private actions perform a critical role in preserving the integrity of our securities markets.” Securities Investor Protection Act of 1991: Hearing Before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs, 102d Cong. (1991) at 15-16.

That remains true today. With a limited budget and about four thousand employees, the SEC is responsible for oversight of roughly 40,000 entities. That includes some “17,000 registered funds” and “15,000 investment advisers”; the agency also reviews disclosures from about 7,800 reporting companies.¹⁵ In light of these competing priorities and limited resources, the SEC simply cannot pursue rescission of every contract that violates the ICA. Even in a case where the SEC sought to rescind a contract between a single company and counterparty as violative of securities law, the agency could not be expected to rescind every similar arrangement under its purview. It is no surprise that, in light of the enormous expansion of the SEC’s

¹⁵ 2023 SEC Fiscal Year 2023 Agency Financial Report, at ii.

enforcement apparatus that would be required to ensure contractual compliance with the ICA, Congress chose instead to give parties to those contracts the right to seek rescission.

And even if centralized securities regulators at the state and federal level had more resources, they would lack information necessary to identify contracts that offend securities law. Since government securities regulators are rarely party to contracts with regulated entities, those regulators lack incentives to invest in information about the contents of such agreements. By contrast, commercial counterparties have powerful economic motivations to acquire that information in connection with bargains over contractual terms. That is why, as the Second Circuit observed, Congress chose in Section 47(b) to “provide a remedy that benefits a party ... to a contract whose provisions violate the ICA,” that is, the party best positioned to know that such a provision exists. *Oxford*, 933 F.3d at 105.

Finally, the threat of *ex post* rescission can generally be expected to produce incentives for contracting parties to ensure that their agreement complies with securities regulation. *Cf.* Richard R.W. Brooks & Alexander Stremitzer, *Remedies on and Off Contract*, 20 Yale L.J. 690 (2011). To the degree that such compliance is thought to be desirable, decreasing the expected level of rescission of those contracts by requiring that remedy to be sought only by the government would be harmful to investors.

B. Private Rights to Rescission Can Be Especially Beneficial When Closed-End Fund Governance Arrangements May Violate the Investment Company Act.

Shareholders in most American investment alternatives, such as open-ended mutual funds and exchange-traded funds, have the right to exit—that is, to redeem their shares at the value of the fund’s assets, or net asset value (NAV)—at a time of the investor’s choosing. John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 Yale L.J. 1228, 1246 (2014) (citing Albert O. Hirschmann, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (1970)). Economists and the SEC alike have long recognized that this exit right alone provides significant protection to investors.¹⁶

The reason is that the *ex ante* threat of exit deters fund managers from opportunism, since incumbent managers will fear that substantial redemptions will follow weak returns.¹⁷ In fact, the financial economics

¹⁶ *E.g.*, U.S. Sec. & Exch. Comm’n, Final Rule, Exchange Traded Funds, Rel. No. IC-33646 (Sept. 25, 2019) (noting that the SEC has “relied on th[e] close tie between what retail investors pay (or receive) in the secondary market and an [exchange-traded fund’s] approximate NAV to find that ... exemptions [for ETFs from certain SEC requirements] are necessary or appropriate” (citing Henry T.C. Hu & John D. Morley, *A Regulatory Framework for Exchange-Traded Funds*, 91 S. CAL. L. REV. 839 (2018))).

¹⁷ Morley, *Separation of Funds and Managers*, *supra*, at 1249-50 (arguing that “redeeming and switching to a fund that operates in the competitive portion of the market can almost always produce as much benefit” for investors as other governance mechanisms, such as voting) (citing John C. Coates IV & R. Glenn Hubbard, *Competition in the Mutual Fund*

literature offers evidence that underperformance in open-ended mutual funds leads to significant fund outflows. *See generally* Susan E.K. Christoffersen, David K. Musto & Russ Wermers, *Investor Flows to Asset Managers: Causes and Consequences*, 6 Ann. Rev. Fin. Econ. 289 (2014). Among mechanisms for disciplining wayward management, exit is often the lowest-cost alternative for investors. *See generally* John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 Colum. L. Rev. 1277 (1991). That is why scholars have long said, in mutual funds that give investors the right to sell their shares at NAV, simply exiting the underperforming fund is often preferable to the alternatives.¹⁸

But closed-end funds do not provide investors with the right to redeem their shares at NAV. In fact, a substantial proportion of CEFs today do not give investors any right *ever* to redeem their shares. And while CEF investors can sell their shares on stock exchanges, the price at which they can sell often reflects a discount to NAV. *See* Charles M.C. Lee, Andrei Shleifer & Richard H. Thaler, *Investor Sentiment and the Closed-End Fund Puzzle*, 46 J. Fin. 75 (1991). Accordingly, the right to rescission granted by Section 47(b) is a rare mechanism for CEF investors to address arrangements that protect incompetent incumbents from accountability.

Petitioners' amici suggest that acknowledging that Section 47(b) confers a right to rescission will cause the securities-law sky to crash down around us. *E.g.*, Chamber of Commerce Br. 16-24. But even casual

Industry: Evidence and Implications for Policy, 33 J. CORP. L. 151 (2007)).

¹⁸ Morley, *Separation of Funds and Managers*, *supra*, at 1250.

consideration of law or economics puts that claim wide of the mark. As to the former, the Government agrees that the original text of the ICA, in place from 1940 to 1980, conferred such a right, yet capitalism (and CEFs) escaped catastrophe during that period. As to the latter, because shareholders in any enterprise are rationally apathetic and face collective-action problems, they have little incentive to bear the considerable costs of an action for rescission—which may be why it has been relatively rarely invoked for years. *See, e.g.,* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. Chi. L. Rev. 877 (1987).

Thus, the ICA’s longstanding private right to rescission is particularly important in the context in which this case arises: a CEF’s adoption of management-friendly governance arrangements that arguably violate the ICA. Closed-end fund activists such as the respondent give investors a mechanism to address underperformance: a fellow shareholder willing to challenge incumbent managers. The finance literature, including a well-known “comprehensive empirical study” on the subject, shows that this mechanism is especially effective with respect to underperforming funds. Michael Bradley, Alon Brav, Itay Goldstein & Wei Jiang, *Activist Arbitrage: A Study of Open-Ending Attempts of Closed-End Funds*, 95 J. Fin. Econ. 1 (2010). Indeed, challengers like respondent tend to target CEFs whose shares trade at relatively large discounts to NAV. *Id.*

Those efforts, the evidence shows, benefit CEF investors in two ways: first, directly, by reducing the discount to NAV at targeted funds substantially. Second, CEF activists’ work indirectly benefits even non-targeted funds by creating a meaningful threat to

other fund managers that underperformance may be met by market-driven challengers. *Id.* (direct effects of challenges can “reduce the discount of the targeted funds by more than 10 percent on average”); *id.* (challenges “affect[] CEF discounts not only via the direct effect on the targeted funds, but also via an indirect anticipation effect”).

In response to these investors’ challenges, CEFs have attempted to adopt governance arrangements that limit, or in some cases eliminate, investors’ right to remove incumbent managers. Some appear to be authorized by state law.¹⁹ Others take the form of proposed changes to stock-exchange rules that would eliminate the requirement that CEFs hold annual meetings at which shareholders can elect directors.²⁰ In defense of those arrangements, counsel to CEFs have taken the position that “[n]othing in the 1940 [Investment Company] Act requires that a [closed-end] fund’s directors be elected by the fund’s public shareholders.”²¹

The prominence of management-friendly governance arrangements at CEFs sheds light on the economic wisdom of Congress’s decision to create a private right

¹⁹ See, e.g., MD. CORP. & ASSOC. CODE §§ 3-701 – 3-710 (the Maryland control-share statute at issue below).

²⁰ E.g., U.S. Sec. & Exch. Comm’n, New York Stock Exchange LLC, Notice of Filing of Proposed Rule Change Amending Section 302.00 of the NYSE Listed Company Manual to Exempt Closed-End Funds Registered Under the Investment Company Act of 1940 from the Requirement to Hold Annual Shareholder Meetings, 89 Fed. Reg. 56447 (2024).

²¹ Memorandum of Law in Support of Defendants’ Motion to Dismiss *in Saba Capital Master Fund, Ltd. v. BlackRock ESG Capital Allocation Term Trust*, No. 24-cv-01701, Dkt. No. 28, at 16 (SDNY Apr. 3, 2024).

of rescission for contracts that violate the ICA. To see why, suppose that a closed-end fund, along with many other similar CEFs, adopted a governance arrangement that would clearly violate the ICA—for example, by staggering director elections such that a director’s term exceeded five years.²² If the right to rescission were limited to the SEC, there is a substantial probability that the Commission’s resource constraints might preclude any litigation on the subject—and certainly those constraints would keep the Commission from obtaining rescission of *every* such arrangement. In fact, even here, where a private party succeeded in persuading the federal courts that a CEF’s governance arrangements violated the ICA and should be rescinded, the SEC has chosen not to use its scarce resources to obtain rescission of those arrangements at all funds.

By contrast, the private right that Congress chose increases the likelihood that a shareholder will invest the resources necessary to obtain rescission of such arrangements. Of course, even in the presence of a private right, some arrangements that violate the ICA may not be rescinded due to the collective-action problems faced by public investors. But the private right to rescission that Congress drew from state blue sky laws and the Exchange Act puts the economic incentives of CEF investors to work in obtaining compliance with the ICA. Those incentives can be especially valuable in cases where funds seek to adopt

²² See 15 U.S.C. § 80a-16(a) (“Nothing herein shall, however, preclude a registered investment company from dividing its directors into classes . . . : Provided, That no class shall be elected for a . . . period longer than five years”).

governance arrangements in violation of the ICA that protect incumbent managers at investor expense.

CONCLUSION

Drawing on state blue sky laws and the Exchange Act, the Congress that enacted the ICA in 1940 created in Section 47 a private right to rescind contracts that violated the law Congress had chosen. The amendments to Section 47 that followed this Court's decision in *TAMA* provide little basis to think that Congress abandoned that judgment in 1980. Economic analysis offers a clear reason for lawmakers' longstanding view that private rights to rescission of contracts that violate organic securities law offer a valuable mechanism for policing compliance. That analysis is especially compelling where closed-end funds adopt incumbent-friendly governance arrangements and investors lack the exit rights that can otherwise discipline underperforming managers. Accordingly, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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