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December Calendar of Cases

FS Credit Opportunities Corp. v. Saba Capital Master Fund

SECURITIES LAW

Does Section 47(b)(2) of the Investment Company Act Give Parties a Private Right of Action for Recission?

CASE AT A GLANCE

Saba Capital filed a suit to rescind the control share provisions in the bylaws of 11 funds that were adopted under Maryland law. The provisions limit the rights of shareholders to vote no more than 10 percent of share in a company. Saba argues that these provisions are inconsistent with Section 18(i) of the Investment Company Act (ICA), 15 U.S.C. § 80a-46 (b), which provides for equal voting rights. Saba sought to exercise the private right of action to rescind the illegal provisions under Section 47(b)(2) of the ICA.

FS Credit Opportunities Corp. v. Saba Capital Master Fund
Docket No. 24-345

Argument Date: **December 10, 2025** From: **The Second Circuit**

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Introduction

Saba Capital Master Fund challenged the control share provisions in 11 funds, claiming that such provisions are an outright violation of the equal voting rights provision in Section 18(i) of the Investment Company Act of 1940 (ICA), 15 U.S.C. § 80a-46 (b). The district court and Second Circuit agreed that the control share provisions under Maryland law are inconsistent with Section 18(i) of the ICA. The lower courts thereby granted Saba the right to private action under Section 47(b) of the ICA to rescind the violating provisions. The petitioners petitioned to the Supreme Court to overrule the judgment of the Second Circuit.

Issues

Does Section 47(b)(2) of the ICA grant any party to an illegal contract a private right of action for recission?

Facts

In 2010, the Securities and Exchange Commission (the SEC or Commission) issued a letter to Boulder Total Return Fund, Inc. (Boulder letter), informing it that the control share provision of the Maryland Control Share Acquisition Act (MCSAA) is inconsistent with the ICA. Specifically, the control share provision in the MCSAA provides that "holders of control shares…have no voting rights with respect to control shares except to the extent approved by the stockholders at a meeting…by the affirmative vote of two-thirds of all the votes entitled to be cast…" This provides an antitakeover measure for companies, which the SEC explained in the Boulder letter is inconsistent with Section 18(i) of the ICA. Section 18(i) states that every share of stock issued by the fund be a voting stock and have equal voting rights with every other outstanding voting stock.

On March 12, 2020, the president of the Investment Company Institute (ICI) asked the Commission to withdraw the Boulder letter because it prevents closed-end fund (CEF) directors from employing antitakeover measures to protect their interest from investors who seek to convert CEFs to open-end funds (OEFs) by appointing directors who will require the sale of CEF shares at or near net asset value (NAV). In this way, CEFs differ from OEFs

because they are not required to redeem or buy back the shares of their investors, and when they do, it is usually at a discount to the NAV. ICI stated that the ICA also seeks to protect the interest of long-term shareholders against self-interested investors who are only interested in "short-term profits."

In response, the Commission issued a letter to withdraw the Boulder letter in May 2020. The Commission stated that it will not recommend enforcement action under Section 18(i) of the ICA against a CEF for adopting a control share statute. Control share statutes provide companies with the "right to prevent or restrict certain changes in corporate control by altering or removing voting rights when a person acquires….the ownership of, control shares…"

After the withdrawal of the Boulder letter, CEFs began to adopt control share provisions as an antitakeover measure against activist investors. Saba Capital Management, a New York manager for certain investment funds, including Saba Capital Master Fund, Ltd. (Saba), usually purchases voting shares in CEFs with the purpose of electing directors who will advance its interests of converting CEFs to OEFs by buying back shares or redeeming shares at prices close to their NAV.

Saba purchased shares in the following funds: (1) BlackRock ESG Capital Allocation Term Trust (ECAT) and BlackRock Municipal Income Fund, Inc. (MUI); (2) Royce Global Value Trust, Inc. (RGT); (3) Tortoise Midstream Energy Fund, Inc., Tortoise Energy Independence Fund, Inc., Tortoise Pipeline & Energy fund, Inc., Tortoise Energy Infrastructure Corp., and Ecofin Sustainable and Social Impact Term Fund (collectively, the Tortoise Funds); (4) Adams Diversified Equity Fund, Inc., and Adams Natural Resources Fund (collectively, the Adams Funds); and (5) FS Credit Opportunities Corp (collectively the Funds). The Funds adopted the Maryland control share provision, which limits the voting rights of shareholders that own 10 percent or more of a company. Specifically, Section 3-702(a)(1) of the MCSAA provides that "holders of control shares…have no voting rights with respect to control shares except to the extent approved by the stockholders at a meeting…by the affirmative vote of two-thirds of all the votes entitled to be cast…"

Saba sued 16 CEFs for adopting control share provisions under MSCAA that violate the equal voting rights provision of Section 18(i) of the ICA. Section 18(i) 15 U.S.C. § 80a-18(i) provides that "[e]xcept as provided in subsection (a) of this section, or as otherwise required by law, every share of stock by a registered management company…shall be a voting stock and have equal voting rights with every other outstanding stock." This provision is designed to preserve the equal voting rights of stocks.

The Funds argued that the control share provision under Maryland law is valid under Section 18(i) of the ICA because it is a provision that is "otherwise required by law." In response, Saba claimed that the control share provisions are inconsistent with the ICA because they are not required by law but are voluntary opt-in provisions that any corporate board may adopt by a board resolution.

Saba argued that the ICA guarantees shareholders equal voting rights to serve as a check on fund managers and officers. Saba claimed that by restricting the vote of shareholders with 10 percent or more, fund insiders limit the ability of shareholders to remove underperforming trustees or fund management from funds.

Saba therefore sought to rescind the control share provisions pursuant to Section 47(b) of the ICA. Section 47(b)(2) provides that if a contract, including a corporation's bylaws, violates the ICA, the court may grant recission at the instance of any party "unless such courts find that under the circumstances the denial of recession would [1] produce a more equitable result than its grant and [2] would…be […] consistent with the purpose of this subchapter."

Saba claimed that it purchased significant shares in the Funds with the hope of exercising its equal voting rights. Saba claimed it had standing to sue, on the basis that it would not have acquired a 10 percent stake in the funds if it were not for the control share provision. Saba supported this argument with evidence of investment planning, coupled with the fact that Saba has a track record of acquiring large stakes in CEFs.

The district court dismissed Saba's claims against five funds because the forum-selection clauses in their bylaws required suit in Maryland. The district court, however, granted summary judgment in favor of Saba for the remaining 11 funds. The court held that the control share provision violated the ICA because the owner of more than 10 percent stock cannot presently vote their stock, therefore making it a nonvoting stock. The court held that the control share provision deprives some shares of voting power, contrary to the equal voting rights provision under Section 18(i). The court also reasoned that the control

share provision is inconsistent with the ICA because it functions as a protective device that CEFs may employ at will or voluntarily, not mandatorily, and it is not a provision "required by law." The court therefore required that each of the offending board resolutions in the Funds be rescinded pursuant to Section 47(b) of the ICA.

The Second Circuit affirmed on merits, agreeing that the control share provisions violated the ICA by denying some shareholders the right to vote their shares and depriving some shares of equal voting right. The court also upheld "the right of a party to ICA-offending contracts to seek rescission."

The Second Circuit "found an implied private right of action in Section 47(b) of the ICA…for rescission of contracts that violate any provisions of the ICA" in *Oxford University Bank v. Lansuppe Feeder*, LLC, 933 F.3d 99 (2d. Cir, 2019). However, the Third and Ninth Circuits do not recognize this implied right to private action, creating a circuit split.

The Funds petitioned for a writ of *certiorari* on September 24, 2024. The Supreme Court has jurisdiction under 28 U.S.C. § 1254(1). Two of the defendant-appellants in the lower court, ECAT and MUI, moved to participate as respondents at the Supreme Court.

Case Analysis

The petitioner Funds claim that Section 47(b)(2) does not provide a private right of action, but rather "establishes the rules for rescission for parties already before the court…". The Funds claim that "every court of appeal…" except the Second Circuit has held that Section 47(b) does not "expressly state that a party to an illegal contract may sue to rescind it." The Funds assert that recognizing a private right of action under Section 47(b) will permit recission of a majority of the contracts entered by an investment company.

Additionally, the Funds and their amici claim that recognizing this right to private action will lead to a wasteful litigation expense and upend already established methods of regulating fund practices by the SEC. This would inevitably lead to a "back door" of cases alleging ICA violation. Consequently, the Funds argue that Saba should channel its challenge through the SEC for enforcement and "not through private suit." The Funds claim that the sole question is "whether Congress intended to create the private right of action asserted."

In response, Saba claims that the Second Circuit was correct when it recognized that Section 47(b)(2) creates "a right to rescission, not compensatory damages…[for] parties to illegal contract." Saba also argues that a private right of action for recission under ICA Section 47(b)(2) will not undermine the SEC's enforcement powers because similar provisions exist under the Investment Advisers Act of 1940 (IAA) and the Securities Exchange Act of 1934 (Exchange Act). Saba notes that the existence of the private right of action in the IAA and the Exchange Act has not in any way hindered the SEC's broad enforcement powers. Therefore, Saba concludes, recognizing such a right under the ICA will similarly not hinder the SEC's broad enforcement powers.

Further, Saba explains that Congress intended for "part[ies]" to an illegal ICA contract to exercise the right to private action for recission under Section 47(b), and not the "Commission." Saba's amici also state that lawmakers recognized that the "private right to rescind contracts that violates securities law can be an efficient means of policing compliance." Saba and its amici claim that the provision in Section 47(b) of the ICA is similar to Section 29(b) of the Exchange Act, which gives "'victims' of a securities violation 'the right to rescind the offending contract.'"

The petitioner Funds claim that Section 47(b) is an "affirmative defense to a breach of contract claim" that operates as a "remedial provision that generally renders contracts violating the ICA unenforceable and subject to rescission…" The Funds state that Section 47(b) is not "aimed at a class of plaintiff because it is directed at courts…" not "individual investors like Saba." They argue that Congress did not imply a private right of action because Section 47(b) does not "confer rights on private parties, nor prescribes any conduct as unlawful."

Saba and their amici counter that Section 47 "unambiguously" refers to claims brought by "any party," not only by the SEC. Respondents' amici also note that "the SEC…cannot pursue recission of every contract that violates the ICA" due to its "competing priorities and limited resources."

Significance

It is common for companies to employ antitakeover measures, like the control share provision in this case, to protect the interest of firm management. Although activist

shareholders may seek to influence the direction of the company by electing nominee directors, it is worth noting that controlling shareholders such as directors and officers also owe a fiduciary duty to all shareholders.

It is important to preserve the voting rights of controlling shareholders as this is an essential feature of corporate governance and an important tool for shareholders to hold management accountable. Shareholders also vote to elect board members who will act in the best interest of the company and move the company forward. When controlling shareholders do not act in the best interest of the corporation, other shareholders can also sue them for breaching their fiduciary duty obligations to the corporation.

Generally, shareholders' right to vote controlling shares is just as essential in a CEF as it is for shareholders in an OEF, if not more so, because CEFs do not redeem shares on demand. Thus, it is crucial for investors with controlling shares to exercise their voting rights without any restrictions to serve as a check on the fund's management and to determine the direction of the fund. Funds that are weary of the sweeping actions by an activist investor may employ other antitakeover measures that do not interfere with the voting rights of controlling shares, including the use of staggered boards and supermajority vote requirements for significant corporate actions such as converting a CEF to an OEF or liquidating a corporate asset. The use of supermajority provisions for significant corporate changes ensures that any decision to change the corporate structure reflects the desires of at least two-thirds of the shareholders rather than a decision taken solely by the activist investor. Such provisions can also be used as an antitakeover mechanism for other board-level decisions.

Invalidating the right of private actions for plaintiffs under Section 47(b) of the ICA may deprive a "party to an illegal contract" the right to seek recission in court. The ICA was established with the goal of protecting investors from fraudulent and illegal contracts, and the right to private action gives individuals the personal right to seek rescission of the violating contract in court without the involvement of any third-party intermediary.

If the Court should find that Section 47(b)(2) does not provide a private right of action, CEFs may continue to adopt provisions that violate the ICA, like the one contemplated in this case. The adoption of such illegal provisions may continue unchecked if parties do not have the private right of action to rescind such provisions in court and if the SEC fails to pursue remedial action on behalf of the parties.

Similarly, the right to private action in Section 47(b)(2) seems consistent with the core objective of the ICA: protecting investors from fraudulent and illegal contracts. Failure to recognize this right may reduce the avenue for remedial action available to parties to an ICA-violating contract. This could also create uncertainty as to the appropriate process parties to ICA-violating contracts may pursue for remedial action. Failing to recognize this right may also undermine Congress's intent when it created such provision. And investors may otherwise not have the private right of action for rescinding illegal ICA contracts.

A failure to recognize the private right of action may also lead to uncertainty about the validity of provisions that purport to offer a private right to action in the IAA and the Securities Exchange Act. This could thwart Congress's intent and create speculations as to the availability of that right for victims of illegal contracts.

If the Court recognizes a private right of action under Section 47(b)(2), then the remedy of rescission, not compensatory damages, may be available to investors who are parties to illegal contracts under the ICA. This will strengthen the validity of provisions that offer a private right of action in other legislation.

Finally, requiring parties to an illegal ICA contract to pursue remedy through the SEC may lead to delayed justice, unnecessary costs, and avoidable backlog if courts cannot directly award that remedy at the instance of an individual party.

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