Louisiana Law Review

Volume 81
Number 3 *Spring 2021*

Article 14

4-29-2021

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I would like to thank several people for their support while writing this Comment. First, Professor Greg Smith, who guided me through the critical thinking process needed to write this Comment. Second, Professor Christina Sautter, who ensured that my understanding of the business-related issues surrounding this Comment was sound. Finally, my family and friends, who supported me throughout this process.

INTRODUCTION

The Investment Company Act of 1940 (ICA) regulates mutual funds and other pooled investment devices.[1] To understand how a mutual fund works, suppose Jordan Belfort from *The Wolf of Wall Street* is released from prison after serving his sentence for defrauding investors.[2] During his time in prison, Jordan determined that his new purpose in life was to invest people's money safely and efficiently though the use of mutual funds. While Jordan was incarcerated, Chester, Donnie, and Nicky were busy making sizeable salaries.[3] Jordan proposes that Chester, Donnie, and Nicky should pool their assets into a common fund and allow Jordan to manage the fund for a management fee.[4] According to the proposal, Chester, Donnie, and Nicky will receive tradable shares in the pooled fund proportional to their investments.[5] Jordan further emphasizes the advantages that pooling assets into a common fund produces and that individual investors cannot achieve alone: lower administrative costs through economies of scale, professional portfolio management, and reduced risk through a more diversified investment portfolio.[6] Specifically, Jordan proposes the use of a mutual fund with himself as the investment adviser. Mutual funds are "pooled investment vehicles" that fall within the scope of ICA regulation.[7] Furthermore, because Jordan is a mutual fund investment adviser, the ICA regulates his behavior.[8] Jordan's main role as investment adviser is fund management.[9]

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1. Mark Holland et al., *Investment Company Act Circuit Split Exposes Mutual Funds*, LAW360 (Aug. 26, 2019, 2:26 PM), https://www.law360.com/articles/1192402/investment-company-act-circuit-split-exposes-mutual-funds [https://perma.cc/2TH9-2YK8].

2. Jordan Belfort was the founder of the investment firm Stratton Oakmont. Belfort and the firm scammed investors using a variety of wrongful tactics. The movie *The Wolf of Wall Street* encapsulates Belfort's wrongful investing tactics and his loose lifestyle. THE WOLF OF WALL STREET (Paramount Pictures 2013). This hypothetical does not consider the ramifications of re-certification of investment advisers after conviction for defrauding investors.

3. Chester, Donnie, and Nicky are three characters, loosely based on real individuals, who helped Jordan Belfort build Stratton Oakmont. *Id.*

4. *See, e.g.*, Northstar Fin. Advisors Inc. v. Schwab Invs., 779 F.3d 1036, 1040 (9th Cir. 2015).

5. *See, e.g.*, *id.*

6. *See, e.g.*, *id.*

7. Holland et al., *supra* note 1.

8. 15 U.S.C. § 80a–1 (2019).

9. *Northstar*, 779 F.3d at 1040.

Chester, Donnie, and Nicky needed some convincing, so Jordan produced the mutual fund prospectus.[10] The prospectus indicates a conservative strategy with modest, long-term objectives. The prospectus shows the diverse range of securities within the Standard and Poor's 500 (S&P 500) that the fund will invest in.[11] The prospectus indicates Jordan's salary will be calculated based on the overall performance of the mutual fund. The prospectus convinces Chester, Donnie, and Nicky to invest in the mutual fund under Jordan's leadership. While managing the fund, Jordan reminisces about his days at Stratton Oakmont and realizes he has an opportunity to further his own financial position if he invests his client's funds in high-risk, high-reward penny stocks.[12] Because Jordan's salary is linked to the performance of the fund, the faster the mutual fund grows, the more money he will make. The growth rate of the S&P 500 stocks pales in comparison to the possible growth of a successful penny stock.[13] Jordan selects new penny stocks he believes are bound to appreciate in value, and, unbeknownst to the investors, he sells the mutual fund's S&P 500 stocks and purchases the risky penny stocks. Unfortunately for Jordan and the investors, the penny stocks become worthless within a few days of Jordan's risky move. Jordan directly violated the terms of the prospectus when he invested in the risky penny stocks. The investors believed they were investing in a relatively safe, conservative fund; however, Jordan exposed the investors to excessive risk through his self-motivated investment tactics. Chester, Donnie, and Nicky have lost substantial amounts of their life savings because of the self-serving actions of their investment adviser. Certain sections of the ICA may provide the unsuspecting investors with a private right of action against the fund and

10. The prospectus is the legally binding contract between the fund and the fund holder. Shauna Carther Heyford, *Digging Deeper: The Mutual Fund Prospectus*, INVESTOPEDIA, https://www.investopedia.com/articles/mutualfund/04/032404.asp [https://perma.cc/GEB9-AZ6F] (last updated May 17, 2019).

11. The S&P 500 is an index that tracks the top 500 stocks as determined by total market capitalization. Will Kenton, *S&P 500 Index – Standard & Poor's 500 Index*, INVESTOPEDIA, https://www.investopedia.com/terms/s/sp500.asp [https://perma.cc/Q5TL-ZWNU] (last updated Sept. 8, 2020).

12. Stratton Oakmont was the investment company Jordan Belfort founded. He used the company to defraud investors. THE WOLF OF WALL STREET, *supra* note 2.

13. Chris B. Murphy, *Penny Stock*, INVESTOPEDIA, https://www.investopedia.com/terms/p/pennystock.asp [https://perma.cc/8RW4-MAXH] (last updated Nov. 17, 2020).

Jordan, its adviser; however, the current state of the law makes their ability to recover unclear.[14]

Section 47(b)(2) of the ICA may provide the remedy the investors need to recover from Jordan.[15] Section 47 states that if the terms of an investment contract or the performance thereof violate another section of the ICA, "a court may not deny rescission" to any party to the contract.[16] Courts disagree about whether § 47(b)(2) creates a private right of action for rescission of investment contracts.[17] For example, in *Santomenno ex rel. John Hancock Trust v. John Hancock Life Insurance*, the Third Circuit found there was no private right of action for rescission under § 47(b)(2).[18] Conversely, in *Oxford University Bank v. Lansuppe Feeder, LLC*, the Second Circuit held that a private right of action for rescission exists under § 47(b)(2).[19]

Although *Oxford* recognized the existence of a private right of action for rescission, the court denied rescission to the plaintiffs.[20] The *Oxford* court presented sound reasoning in support of its conclusion that a private right of action for rescission exists under § 47(b)(2); however, because the court failed to grant rescission, it is unclear what circumstances are required to recognize such a right.[21] The uncertainty surrounding the *Oxford* decision has caused concern among investment companies because a private right of action for rescission poses an increased risk of litigation, and, if rescission is granted, it poses a risk to their financial stability.[22] As expressed in the findings and declaration of policy section of the ICA, investment companies are vital to the health of the U.S. economy.[23] Congressional policymaking should balance investors' rights with American citizens' interest in a stable U.S. economy. With these competing interests in mind, a private right of action for rescission exists under § 47(b)(2) when a contract violates or causes a violation of another

14. *See* Holland et al., *supra* note 1.

15. *See generally* 15 U.S.C. § 80a–46(b)(2) (2019).

16. *See* 15 U.S.C. § 80a–46. Investment advisers' breach of the fiduciary duty they owe to investors of investment companies is a violation of the ICA for which plaintiffs may seek rescission. *See* 15 U.S.C. § 80a–35(a).

17. *See* Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99 (2d Cir. 2019); Santomenno *ex rel.* John Hancock Tr. v. John Hancock Life Ins., 677 F.3d 178 (3d Cir. 2012).

18. *Santomenno*, 677 F.3d 178.

19. *Oxford Univ. Bank*, 933 F.3d 99.

20. *Id.* at 109.

21. *See generally Oxford Univ. Bank*, 933 F.3d 99.

22. *See* Holland et al., *supra* note 1.

23. 15 U.S.C. § 80a–1 (2019).

section of the ICA, and courts should recognize such a right.[24] The language of § 47(b)(2) evinces a clear legislative intent to provide a private right of action for rescission.[25] Furthermore, Senate and House committee reports produced when Congress amended the ICA in both 1970 and 1980 support a private right of action for rescission under § 47(b)(2).[26] Although a private right of action for rescission exists under § 47(b)(2), the principles of standing, judicial discretion (as provided for in § 47(b)(2)), and severability (as provided for in § 47(b)(3)) limit the negative financial effects that recognizing such a private right of action could produce for the investment company industry.[27] Courts should consider these restraints when presented with cases seeking rescission of investment contracts under § 47(b).

Part I of this Comment will discuss the provisions of the ICA that are relevant to private rights of action for rescission. Part I will further discuss the statutory scheme of the ICA and the history of judicial recognition of private rights of action under the ICA. Next, Part II will present the current circuit split regarding private rights of action under § 47(b)(2). Specifically, Part II will analyze both *Santomenno* and *Oxford*.[28] Part III will argue that a private right of action does exist under § 47(b)(2); however, the right of action is limited because of principles of standing, judicial discretion, and severability. Finally, Part IV will conclude that a private right of action for rescission under § 47(b)(2) is consistent with the ICA's statutory scheme, especially considering the limitations of the private right of action.

I. THE INVESTMENT COMPANY ACT: AN OVERVIEW AND JUDICIAL HISTORY

Congress enacted the ICA in response to pervasive fraud and mismanagement in the investment company industry throughout the 1930s.[29] The findings and declaration of policy section expresses the

24. *See generally Oxford Univ. Bank*, 933 F.3d 99.

25. *Id.* at 105.

26. S. REP. NO. 91-184 (1970); H.R. REP. NO. 96-1341, at 29 (1980).

27. *See* Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992); 15 U.S.C. § 80a–46.

28. Santomenno *ex rel.* John Hancock Tr. v. John Hancock Life Ins., 677 F.3d 178 (3d Cir. 2012); *Oxford Univ. Bank*, 933 F.3d 99.

29. H. Norman Knickle, *The Investment Company Act of 1940: SEC Enforcement and Private Actions*, 23 ANN. REV. BANKING & FIN. L. 777, 778 (2004). The ICA defines an "investment company" as an entity that is or holds itself out to be mainly engaged in investing, reinvesting, or trading securities.

objectives of the ICA.[30] This section indicates that the regulation of investment companies is of national importance because investment companies are a popular avenue for private investment in the U.S. economy.[31] Furthermore, as a popular avenue for private investment, investment companies tremendously affect the flow of savings to the national economy.[32]

The findings and declaration of policy section further elaborates that the influence of investment companies is so vast that the national public interest and the interest of investors are negatively impacted when investment companies fail to fairly present information regarding the nature of their investment vehicles; when the directors, officers, investment advisers, and others affiliated with such people invest funds in their own self-interest or the interest of other third parties; or when funds are invested with excessive risk such as the use of pyramiding to invest funds.[33] In response to these issues, the ICA requires investment companies to register with the Securities and Exchange Commission (SEC) and to provide the SEC and their customers with financial information.[34] Furthermore, the ICA addresses the significant role of fund directors and regulates conflicts of interest and fiduciary duties.[35]

Congress recognized that many of the abuses in the mutual fund industry arise because of the unique relationship between investment advisers and the funds they manage.[36] Specifically, Senate Report Number 184 manifests this understanding:

> A typical fund is organized by its investment adviser which

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Companies that issue face-amount installment certificates and companies with assets comprised of more than 40% investment securities are also considered investment companies. 15 U.S.C. § 80a–3.

30. 15 U.S.C. § 80a–1.

31. *Id.*

32. *Id.*

33. *Id.* Pyramiding occurs when an investor buys shares of stock in a company containing options to buy additional stock at a predetermined price. When the shares of stock increase in value, the investor sells some of the stock and uses the funds to purchase stock at the option price contained in the remaining shares of the same company. The process can be undertaken to slightly increase the number of shares in a company that an investor has, so long as the price of the stock increases. Will Kenton, *Pyramiding*, INVESTOPEDIA, https://www.investopedia.com/terms/p/pyramiding.asp [https://perma.cc/F8JF-F7XX] (last updated Feb. 26, 2018).

34. 15 U.S.C. § 80a–8; *id.* § 80a–29.

35. Knickle, *supra* note 29, at 783.

36. *See* Lessler v. Little, 857 F.2d 866, 870 (1st Cir. 1988).

> provides it with almost all management services. . . . [A] mutual fund cannot, as a practical matter sever its relationship with the adviser. Therefore, the forces of arm's-length bargaining do not work in the mutual fund industry in the same manner as they do in other sectors of the American economy.[37]

Consider the relationship between advisers and mutual funds the ICA targets in the context of the Jordan Belfort example.[38] Jordan Belfort performs all of the managerial services for the fund, such as choosing which securities to invest in and when to do so. As the investment adviser for the fund, Jordan owes his investors a fiduciary duty, or a duty to act in their best interest.[39] Juxtaposed to Jordan's fiduciary duty is the idea that Chester, Donnie, and Nicky are poorly positioned to sever their investment relationship with Jordan if Jordan goes rogue and acts against their best interest. If they fire Jordan, they have lost the person with the knowledge to invest their money properly. Congress enacted the ICA in light of this conflict of interest as well as reports of investment advisers victimizing security holders.[40]

The ICA has undergone two series of amendments since its enactment in 1940.[41] Congress first amended the ICA in 1970 when it divided § 36 into subsections (a) and (b).[42] Subsection (a) contemplates a breach of the fiduciary duty relating to the personal misconduct of investment advisers.[43] Subsection (b) imputes a fiduciary duty on investment advisers regarding the fees they charge for their services, and it also provides an explicit private right of action for breach of the fiduciary duty when fees are excessive.[44] Congress amended the ICA for the second time in 1980.[45] The 1980 amendment divided § 47(b) into two paragraphs.[46] Section 47(b)(2) states if the terms of an investment contract or the performance thereof violate another section of the ICA, "a court may not deny rescission at the instance of any party."[47] Whether § 47(b)(2) provides a

37. S. REP. NO. 184, at 5 (1969).
38. *See supra* Introduction.
39. *See Fiduciary Duty*, BLACK'S LAW DICTIONARY (11th ed. 2019).
40. *See Lessler*, 857 F.2d at 870.
41. *See* Knickle, *supra* note 29.
42. *Id.* at 818–19.
43. 15 U.S.C. § 80a–35 (2019).
44. *Id.*
45. *See id.* § 80a–46 (1980).
46. *See id.* § 80a–46 (2019).
47. *See id.*

private right of action for rescission depends heavily on judicial interpretation of other private rights of action under the ICA.

A. A History of Private Rights of Action under the ICA

Throughout the ICA's 80-year existence, courts often faced the issue of enforcement authority.[48] The most obvious conclusion was that the SEC had the power to enforce the ICA given the express authority to do so contained in § 42.[49] Under § 42, the SEC can file suit against violators of the ICA for both injunctions and monetary penalties.[50] Currently, only one section of the ICA, § 36(b), explicitly provides for a private right of action.[51] Congress created § 36(b) in 1970 amid rising instances of investment advisers and fund directors breaching the fiduciary duty they owed to investors.[52] Section 36(b) gives private security holders an explicit right of action for breaches of the fiduciary duty regarding excessive fees paid to investment advisers.[53] For 30 years following the 1970 amendments, courts generally found implied private rights of action under various sections of the ICA.[54]

Although § 36 was not amended to explicitly provide a private right of action until 1970, several federal appellate courts decided cases regarding whether implied private rights of action existed under the ICA before that time.[55] The reasoning used in the pre-1970 cases is foundational to the current-day circuit split.[56] In 1961, the U.S. Eighth Circuit Court of Appeals became the first federal appellate court to decide whether the ICA supported implied private rights of action.[57] In *Brouk v. Managed Funds Inc.*, the plaintiffs sued investment company directors, alleging the directors operated the fund in the interest of the directors, not

48. *See generally* Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99 (2d Cir. 2019); Santomenno *ex rel.* John Hancock Tr. v. John Hancock Life Ins., 677 F.3d 178 (3d Cir. 2012); Jacobs v. Bremner, 378 F. Supp. 2d 861 (N.D. Ill. 2005); Brouk v. Managed Funds, Inc., 286 F.2d 901 (8th Cir. 1961); Brown v. Bullock, 294 F.2d 415, 422 (2d Cir. 1961).

49. 15 U.S.C. § 80a–41.

50. *Santomenno*, 677 F.3d at 187; *Brown*, 294 F.2d at 422.

51. 15 U.S.C. § 80a–35.

52. Knickle, *supra* note 29, at 814–15.

53. 15 U.S.C. § 80a–35. Note in § 36(c) the term "investment adviser" includes trustees who perform the function of an investment adviser.

54. Knickle, *supra* note 29, at 814–15.

55. *See* Brouk v. Managed Funds, Inc., 286 F.2d 901 (8th Cir. 1961); *Brown*, 294 F.2d 415.

56. Knickle, *supra* note 29, at 813–16.

57. *Id.* at 814–15 (citing *Brouk*, 286 F.2d at 918).

the security holders.[58] The directors published incomplete and false financial statements, derogated from the fund's fundamental investment policy, and allowed individuals to act as investment advisers without a written contract approved by the shareholders.[59] The court ruled that a private right of action required "manifest legislative intent."[60] Essentially, private rights of action required clear congressional authorization; thus, without an express grant by Congress, the court found the plaintiffs had no right of action.[61] Later that year, in *Brown v. Bullock*, the Second Circuit rejected the reasoning of the Eighth Circuit when it held that several sections of the ICA supported private rights of action.[62]

The contradictory conclusions of the Second and Eighth Circuits in *Brown* and *Brouk* hinged on whether the courts applied the doctrine of implied liability.[63] The doctrine of implied liability states that the lack of an express provision for civil liability is not enough to overcome the implications of the overall law, so long as the implications are within the purview of the general purpose of the legislation.[64] The Second Circuit applied the doctrine, whereas the Eighth Circuit did not.[65] The doctrine of implied liability that guided the courts in previous years is similar to the reasoning used in the current circuit split regarding implied rights of action under the ICA.[66]

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran embodies the reasoning courts used to find implied rights of action under federal legislation absent express statutory authorization.[67] In *Curran*, the Supreme Court interpreted federal legislation by considering the "contemporary legal context" in which Congress acted.[68] Under the contemporary-legal-context theory, courts examined "Congress' perception of the law that it was shaping or reshaping."[69] The theory

58. *Brouk*, 286 F.2d at 918.

59. *Id.* The allegations constitute violations of § 80a–1(b)(2), § 80a–33, § 80a–13, and § 80a–15(a), respectively.

60. *Id.*

61. *See id.*

62. *See generally id.*; Brown v. Bullock, 294 F.2d 415, 422 (2d Cir. 1961).

63. Knickle, *supra* note 29, at 815.

64. *Id.* at 815–16 (citing Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946)).

65. *See generally Brouk*, 286 F.2d at 918.

66. Knickle, *supra* note 29, at 816.

67. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982).

68. *Id.*

69. *Id.* at 378.

presents two alternatives depending on whether Congress creates a new statute or amends an old statute under which courts have established an implied private right of action.[70] When Congress enacts new legislation, a court must determine if Congress intended the legislation to supplement pre-existing, express provisions of private enforcement.[71] When Congress acts in a judicial context where courts have recognized an implied private right of action based on an existing statute, the question is whether Congress intended to preserve that implied right of action.[72] When Congress amended the ICA in 1970 and again in 1980, it acted within a judicial context in which a number of courts already recognized implied private rights of action under several sections of the ICA; therefore, the question courts should ask when interpreting the ICA is whether Congress intended to preserve previously existing implied rights of action.[73]

Furthermore, *Fogel v. Chestnutt* exemplifies the line of reasoning courts used to find private rights of action under the ICA after the 1970 amendments using the contemporary-legal-context theory.[74] In *Fogel*, the Second Circuit found an implied private right of action under § 36(a) when an investment adviser and a fund director breached their fiduciary duties.[75] Though § 36(b) contains an express private right of action, the court held that this did not preclude a finding of implied rights under other sections.[76] The court reasoned that Congress added § 36(b) in response to the judiciary's failure to interpret the ICA in such a way as to remedy the wrongs the act was intended to address.[77] The court opined that when § 36(b) was enacted, investment companies charged adviser fees as a

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70. *Id.*

71. *Id.* at 378–79.

72. *Id.*

73. *See generally* H.R. REP. NO. 96-1341, at 29 (1980); S. REP. NO. 91-184 (1970). The importance of courts recognizing implied private rights of action under several sections of the ICA is that the court decisions represent a microcosm of how the judiciary as a whole was interpreting the ICA at the time. The judicial interpretation of current congressional statutes provides Congress with the information it needs to determine whether the rights of action currently recognized are consistent with congressional intent. Presumably, if Congress wants the judiciary to continue to acknowledge a private right of action under a particular statutory scheme or section of a statute, then it will draft legislation accordingly. For such an assertion to be accurate, it is necessary for a majority of courts to act with relative consistency.

74. Fogel v. Chestnutt, 668 F.2d 100, 111 (2d Cir. 1981).

75. *Id.*

76. *Id.* (citing Tannenbaum v. Zeller, 552 F.2d 402, 417 (2d Cir. 1975)).

77. *Id.* at 111–12.

percentage of the market value of managed assets.[78] In *Fogel*, the fees were reasonable when the fund was established; however, they became excessive as the fund grew.[79] The court explained that the judicially recognized implied private right of action in place prior to the enactment of § 36(b) forced private plaintiffs to show gross misconduct on the part of the investment adviser—a threshold rarely, if ever, met.[80] With the high threshold in mind, the SEC proposed a bill that would have required reasonable adviser's fees.[81] The court reasoned that the SEC did not intend amendments made pursuant to the proposed bill to preclude implied private rights of action under other sections of the ICA, as the various amicus curiae briefs that the SEC submitted supported implied private rights of action.[82] The court distinguished § 36(a) from § 36(b).[83] The express private right of action in § 36(b) addressed breaches of fiduciary duty regarding investment adviser fees, while § 36(a), which imputes a general fiduciary duty on the investment fund and its officers, contains an implied private right of action.[84] Although the *Fogel* court rendered its decision a year before *Curran*, the *Fogel* court applied the contemporary-legal-context theory when it concluded that Congress was acting in a judicial context where courts had previously recognized implied private rights of action.[85] The court recognized that Congress intended to preserve the pre-existing implied right of action under § 36(a) even though Congress created an express right of action under § 36(b).[86]

The contemporary-legal-context theory first developed in *Curran* and applied to § 36 of the ICA in *Fogel* is integral for understanding § 47(b).[87] The current version of § 47 was a product of the 1980 amendments to the ICA.[88] Prior to the 1980 amendments, § 47(b) voided all contracts that violated the ICA as written or when performed.[89] The amendment

78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.*
85. *See generally id*. at 111. *See also* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 378–79 (1982).
86. *See generally Fogel*, 668 F.2d at 111. *See also Curran*, 456 U.S. at 378–79.
87. *See generally Curran*, 456 U.S. 353; *Fogel*, 668 F.2d 100.
88. *See* 15 U.S.C. § 80a–46 (2019).
89. *Id.*

bifurcated § 47(b) into paragraphs (1) and (2).[90] Paragraph (1) states that if the terms of the investment contract or the performance thereof violates another section of the ICA, the contract is "unenforceable by either party."[91] Paragraph (2) references performed or partially performed contracts containing terms that violate the ICA or the performance of which violates the ICA and states that "a court may not deny rescission [of such contracts] at the instance of any party."[92] Following the 1980 amendments, the Third Circuit in *Bancroft Convertible Fund v. Zico Investment Holdings, Inc.* provided the specific contemporary legal context in which Congress enacted the 1980 amendments.[93]

In *Bancroft,* the Third Circuit held that § 12(d)(1)(A) of the ICA contains an implied private right of action.[94] Section 12(d)(1)(A) precludes investment companies from purchasing more than 3% of the voting shares of another investment company.[95] The court held that the judiciary consistently found implied rights of action under the ICA; therefore, Congress acted within a "contemporary judicial context" when it amended the ICA in 1980.[96] The court reasoned that in House committee reports from the 1980 amendments, Congress acknowledged the judicial context that it was working within as follows: "the Committee wishes to make plain that it expects the courts to imply private rights of action under [securities laws], where the plaintiff falls within the class of persons protected by the statutory provision in question."[97]

The *Bancroft* court emphasized that implied private rights of action are consistent with and further Congress' intent.[98] The *Bancroft* court used the contemporary-legal-context theory and the reasoning from *Fogel* when it held § 12(d)(1)(A) supported a private right of action.[99]

Within several months of the Third Circuit's *Bancroft* decision, the First Circuit decided *Lessler v. Little*.[100] The First Circuit held § 17(a)(2)

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90. *Id.*
91. *Id.*
92. *Id.*
93. Bancroft Convertible Fund, Inc. v. Zico Inv. Holdings, Inc., 825 F.2d 731, 734 (3d Cir. 1987).
94. *Id.* at 733–36.
95. 15 U.S.C. § 80a–12.
96. *Bancroft*, 825 F.2d at 734 (citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982)).
97. *Id.* at 735.
98. *Id.*
99. *Id.*
100. Lessler v. Little, 857 F.2d 866 (1st Cir. 1988).

included an implied private right of action.[101] Section 17(a)(2) prohibits investment advisers and their affiliates from knowingly purchasing assets of a registered investment company.[102] The plaintiff, Lessler, brought a class action suit on behalf of all shareholders of the Narragansett investment company.[103] The plaintiff sued Narragansett and its officers and directors for rescission of a sales contract under which Narragansett was sold to Monarch Capital Corporation.[104] The sales contract included a retention of "Management Company," the company Narragansett used as its investment adviser.[105] Management Company was Narragansett's investment adviser; consequently, § 17(a)(2) precluded Management Company from knowingly purchasing Narragansett securities.[106] The sales contract violated § 17(a)(2) because it gave Management Company a 20% interest in the profits of Narragansett.[107] The plaintiffs sought rescission of the sales contract under § 47(b) based on the violation of § 17(a)(2).[108] The court found that the sales contract violated § 17(a)(2); however, the court denied rescission under § 47(b).[109] Although the ever-present conflict of interest between a mutual fund and its investment adviser is squarely within the purview of the ICA, the court denied rescission because the investors lacked standing.[110] The court opined that the investors lacked standing because they were not parties to the sales contract; however, the court noted that the investors could acquire standing through a derivative suit brought on behalf of Narragansett.[111] Narragansett had standing because the company was a party to the illegal contract.[112] *Lessler* recognized yet another implied right of action under the ICA; furthermore, the decision also emphasized the important restriction that standing places on private rights of action for rescission under § 47(b).[113]

101. *Id.* at 871–73.
102. 15 U.S.C. § 80a–17 (2019).
103. *Lessler*, 857 F.2d at 868.
104. *Id.* at 867.
105. *Id.* at 868.
106. 15 U.S.C. § 80a–2.
107. *Lessler*, 857 F.2d at 873.
108. *Id.* at 868.
109. *Id.* at 875.
110. *Id.* at 870, 875.
111. *Id.* at 875.
112. *Id.*
113. *See id.* at 866.

B. A Collective Shift in Thought—Denial of Private Rights of Action under the ICA

Since 2001, the jurisprudence has shifted away from finding private rights of action under the ICA primarily because of the Supreme Court's decision in *Alexander v. Sandoval*.[114] *Sandoval* did not directly address the ICA; however, the decision established valuable precedent for statutory interpretation, which explains the general denial of private rights of action under the ICA since 2001.[115]

In *Sandoval*, the plaintiff sued the Alabama Department of Public Safety, alleging a violation of the disparate-impact regulations enacted under Title VI of the Civil Rights Act of 1964.[116] The specific regulations that the plaintiff referenced did not expressly provide for a private right of action.[117] The Court held that Congress must create a private right of action; the judiciary cannot simply provide remedies as it sees fit.[118] The Court further stated that the statute must create both a private right and a private remedy.[119] The opinion expressed that the text and structure of a statute are the primary factors of consideration to determine if a statute grants a substantive right.[120] The decision noted that statutes fail to create an implied intent to confer rights when the statute focuses on the entity regulated and not the individuals protected.[121] The Court held that a statute expressly providing for one method of enforcement creates a presumption that Congress intended to preclude other methods of enforcement not mentioned.[122] Furthermore, the Court articulated that the presumption created when another method of enforcement is provided is sometimes strong enough to overcome congressional intent to create a private right of action.[123] For example, when a statute provides for federal agency enforcement, there exists a presumption that a private right of action is

114. Alexander v. Sandoval, 532 U.S. 275 (2001).
115. *See generally id.*
116. *Id.* at 278.
117. *Id.* at 292.
118. *Id.* (citing Cort v. Ash, 422 U.S. 66 (1975)).
119. *Id.* at 286 (citing Transamerica Mortg. Advisors, Inc. (TAMA) v. Lewis, 444 U.S. 11, 15 (1979)).
120. *Id.* at 288.
121. *Id.* (citing California v. Sierra Club, 451 U.S. 287, 294 (1981)).
122. *Id.* at 291 (citing Karahalios v. Nat'l Fed'n of Fed. Emps., 489 U.S. 527, 533 (1989)).
123. *Id.* at 290 (citing Karahalios v. Nat'l Fed'n of Fed. Emps., 489 U.S. 527, 533 (1989)).

precluded.[124] The opinion emphasized that the presumption created when a statute provides for one method of enforcement may overcome congressional intent to create a private right of action even when the language of the statute makes the plaintiff a "member of the class for whose benefit the statute was enacted."[125] The decision noted the various lower courts that have denied private rights of action even when the statute seemingly creates a private right of action because of the presumption that exists when another method of enforcement is provided.[126]

Moreover, congressional inaction in the face of judicial precedent deserves very little consideration in the interpretive process because it is impossible to determine if congressional inaction indicates approval of judicial interpretation.[127] The decision emphasized this notion when the statutory amendments are isolated to particular sections of a statute as opposed to sweeping overhauls of an entire statute.[128] The *Sandoval* decision seemingly signaled the death of implied private rights of action in general.[129]

II. THE CIRCUIT SPLIT ON § 47(B)(2): AN IMPLIED PRIVATE RIGHT OF ACTION?

The circuit split between the Second and Third Circuits depends on the courts' interpretations of the text of § 47(b)(2) in light of the *Sandoval* holding.[130] In *Santomenno ex rel. John Hancock Trust v. John Hancock Life Insurance Co.*, the Third Circuit found that § 47(b)(2) did not contain rights-creating language; therefore, the statute did not provide a private right of action for rescission.[131] Conversely, in *Oxford University Bank v. Lansuppe Feeder*, *LLC*, the Second Circuit found that although § 47(b)(2) did not contain an express private right of action, it did contain rights-

124. *See id.* at 291 (citing Karahalios v. Nat'l Fed'n of Fed. Emps., 489 U.S. 527, 533 (1989)).

125. *Id.* at 290.

126. *Id.*

127. *Id.* at 292 (quoting Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 187 (1994); Patterson v. McLean Credit Union, 491 U.S. 164, 175 (1989)).

128. *Id.* (quoting Patterson v. McLean Credit Union, 491 U.S. 164, 175 (1989)).

129. *See generally id.* at 290.

130. *See generally* Santomenno *ex rel.* John Hancock Tr. v. John Hancock Life Ins., 677 F.3d 178 (3d Cir. 2012); Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99 (2d Cir. 2019).

131. *Santomenno*, 677 F.3d at 187.

creating language.[132] Furthermore, the *Oxford* court opined that the *Sandoval* decision allowed a court to find a private right of action so long as some textual evidence of one existed.[133]

A. A Denial of a Private Right of Action under § 47(b)(2)

In *Santomenno,* the Third Circuit became the first federal appellate court to rule on a private right of action for rescission under § 47(b)(2).[134] The plaintiffs were participants in an employer-sponsored 401(k) benefit plan.[135] The trustees of the plan entered into group annuity contracts with John Hancock.[136] The plaintiffs alleged John Hancock charged excessive service fees for the management of the 401(k) plans in violation of § 36(b).[137] Additionally, the plaintiffs sought rescission of their investment contracts under § 47(b)(2) pursuant to a violation of § 26(f).[138] Under § 26(f), fees charged under variable insurance contracts must be reasonable and proportional to the services provided.[139]

First, the court analyzed the section of the ICA the defendants allegedly violated: § 26(f).[140] The court held that § 26(f) does not expressly provide for a private right of action for enforcement.[141] The Third Circuit applied the statutory interpretation precept from *Sandoval* that the existence of one method of enforcement suggests congressional intent to preclude other methods of enforcement.[142] The majority opined that § 42 provided the SEC with broad power to enforce the ICA; therefore, it was likely Congress intended to exclude a private right of action as an alternative method of enforcement.[143]

Thereafter, the court reasoned that since the § 26(f) claim failed, the § 47(b)(2) rescission claim also failed because § 47(b)(2) does not create a private right of action.[144] The opinion emphasized that § 36(b)

132. *Oxford Univ. Bank*, 933 F.3d 99.
133. *Id.*
134. *See Santomenno*, 677 F.3d 178.
135. *Id.* at 181.
136. *Id.*
137. *Id.*
138. *Id.*
139. 15 U.S.C. § 80a–25 (2019).
140. *See Santomenno*, 677 F.3d at 185.
141. 15 U.S.C. § 80a–25.
142. *Santomenno*, 677 F.3d at 185; *see also* Alexander v. Sandoval, 532 U.S. 275 (2001).
143. *Santomenno*, 677 F.3d at 186.
144. *Id.* at 185–87.

specifically enumerates a private right of action, while § 47(b)(2) lacks such express language.[145] The court reasoned that it was not likely Congress expressly included a private right of action in § 36(b) yet simply "forgot to mention" a private right of action under § 47(b)(2).[146] Furthermore, the majority opined that because § 42 provides for SEC enforcement, courts should be reluctant to read additional remedies into the statutory scheme.[147] Additionally, the court found that § 47(b)(2) did not contain rights-creating language.[148] Specifically, the court emphasized the language used in § 47(b)(1): "a contract that is made, or whose performance involves, a violation of this title . . . is unenforceable."[149] The opinion stressed that the use of the word "unenforceable" as opposed to "void" as used in other securities regulation acts of the era indicated the defensive nature of § 47(b).[150] The court held that § 47(b) creates "a remedy rather than a distinct cause of action or basis of liability"; therefore, the underlying section of the ICA that is violated must contain rights-creating language.[151] The court reasoned that since § 26(f) does not contain rights-creating language because it focuses on the entity regulated and not the individual protected, no right of action for rescission existed under § 47(b)(2).[152]

Although most courts since *Sandoval* have not found a private right of action for rescission under § 47(b)(2), the United States District Court for the Western District of Tennessee in *In re Regions Morgan Keegan Securities* left the door open for the possibility of a private right of action under § 47(b)(2).[153] The plaintiffs were beneficiaries of a trust fund.[154] The fund manager invested the funds in riskier mutual funds than the prospectus of the trust allowed, which caused the plaintiffs to suffer large financial losses.[155] The plaintiffs sued the trust fund manager, the mutual fund in which the trust was invested, and the underwriters of the mutual

145. *Id.* at 186 (citing *Sandoval*, 532 U.S. at 290).
146. *Id.* (citing Cannon v. Univ. of Chi., 441 U.S. 677, 742 (1979)).
147. *Id.* (citing Cannon v. Univ. of Chi., 441 U.S. 677, 742 (1979)).
148. *Id.* at 178 (citing *Sandoval*, 532 U.S. 275).
149. 15 U.S.C. § 80a–46 (2019).
150. *Santomenno*, 677 F.3d at 187 (citing Transamerica Mortg. Advisors, Inc. (TAMA) v. Lewis, 444 U.S. 11, 18 (1979)).
151. *Id.* (citing Stegall v. Ladner, 394 F. Supp. 2d 358, 378 (D. Mass. 2005)).
152. *Id.* at 186.
153. *In re* Regions Morgan Keegan Secs., Derivative, & ERISA Litig., 743 F. Supp. 2d 744 (W.D. Tenn. 2010).
154. *Id.*
155. *Id.*

fund.[156] The investors sought rescission of the underwriting agreement.[157] The court held that the plaintiffs could not rescind the contract under § 47(b)(2) because they were not parties to the underwriting agreement.[158] Although the § 47(b)(2) claims were dismissed, the opinion cited a consistent line of jurisprudence indicating § 47(b) "contemplates a private right of action."[159] Furthermore, the court noted § 47(b)(2) only contemplates derivative suits whereby a private plaintiff brings suit on behalf of the company as a whole.[160] The plaintiffs brought a personal suit and not a derivative suit; therefore, the plaintiffs' claim was prohibited.[161] *In re Regions Morgan Keegan Securities* planted the seed for a private right of action for rescission under § 47(b)(2) if the plaintiffs are parties to the contract and bring a derivative suit on behalf of all similarly situated investors.[162]

B. A Private Right of Action under § 47(b)(2)

In August of 2019, the Second Circuit derogated from the Third Circuit's holding in *Santomenno* when it decided *Oxford University Bank v. Lansuppe Feeder, LLC*.[163] The *Oxford* court held that § 47(b)(2) contained a private right of action for rescission.[164] In the case, Lansuppe LLC owned two-thirds of the senior notes in the Soloso trust.[165] The Soloso trust issued notes according to its indenture.[166] The Soloso trust

156. *Id.*
157. *Id.* at 762.
158. *Id.* (citing Lessler v. Little, 857 F.2d. 866, 874 (1st Cir. 1988)).
159. *Id.* (citing Lessler v. Little, 857 F.2d. 866, 874 (1st Cir. 1988); Mathers Fund, Inc. v. Colwell Co., 564 F.2d 780, 783 (7th Cir. 1977); Hamilton v. Allen, 396 F. Supp. 2d 545, 558–60 (E.D. Pa. 2005); *In re* Mut. Funds Inv. Litig., 384 F. Supp. 2d 873, 880–81 (D. Md. 2005)).
160. *Id.*
161. *Id.*
162. *See id.*
163. Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99 (2d Cir. 2019).
164. *Id.* at 109.
165. *Id.* at 102.
166. *Id.* "A trust indenture is the agreement in a bond contract made between a bond issuer and a trustee that represents the bondholder's interests . . . ." James Chen, *Trust Indenture*, INVESTOPEDIA https://www.investopedia.com/terms/t/trust_indenture.asp [https://perma.cc/YR35-N5YP] (last updated Mar. 6, 2020). The indenture establishes the rules and responsibilities each party owes the other. *Id.*

was a special purpose vehicle (SPV) used for investment purposes.[167] As an SPV, the trust sold its notes and bought trust preferred securities to collateralize and secure the notes.[168] The interest earned on the trust preferred securities paid noteholder interest.[169] The trust contained several tranches of noteholders, notably one tranche of senior noteholders and several tranches of junior noteholders.[170] In the event of liquidation, the trust entitled the senior noteholders to payment before junior noteholders.[171] When the Soloso trust failed to pay an interest payment to senior noteholders, the trust indenture provided that the trust was in "default."[172] Per the indenture, default triggered several noteholder rights, including the right of two-thirds of the senior noteholders to demand liquidation of the trust assets.[173] Pursuant to this provision, Lansuppe initiated the trust instruction and ordered the trustee, Wells Fargo, to liquidate the trust's assets and distribute the proceeds as set forth in the trust indenture.[174] If the trust was liquidated per the trust's indenture, senior noteholders would be compensated; however, junior noteholders would receive nothing.[175] The junior noteholders objected to the liquidation and alleged Soloso violated §§ 7 and 8 of the ICA, which require investment companies to register with the SEC unless the issuer's notes are owned by "qualified purchasers" when acquired.[176] The language

167. A special purpose vehicle is a company created by a parent company used to isolate or secure assets in a separate company. James Chen, *Special Purpose Vehicle (SPV)*, INVESTOPEDIA, https://www.investopedia.com/terms/s/spv.asp [https://perma.cc/4E9B-KTF3] (last updated June 29, 2020). It is often kept off the balance sheet and is usually created to undertake riskier endeavors while the parent company is protected. *Id.* In this particular case, the purpose of the SPV was to secure debt so as to ensure investors received repayment.

168. *Oxford Univ. Bank*, 933 F.3d at 101.

169. *Id.*

170. *Id.* at 102. A tranche is a group of investment securities, each with a unique amount of risk. James Chen, *Tranches*, INVESTOPEDIA, https://www.investopedia.com/terms/t/tranches.asp [https://perma.cc/5LFJ-7HX9] (last updated Nov. 27, 2020).

171. *Oxford Univ. Bank*, 933 F.3d at 102.

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.* at 101.

176. *Id.* at 103; 15 U.S.C. §§ 80a–6 to 7 (2019). "Qualified purchasers" include individuals with at least $5 million in investments; a company with at least $5 million in investments owned by close family members; a trust, not formed for the investment, with at least $5 million in investments; an investment manager

in Soloso's indenture ensured non-qualified purchasers could not obtain the notes.[177] The indenture only allowed the trust to sell to qualified purchasers, and transfers of trust securities could only be made to other qualified purchasers.[178] Despite the rules set forth in the trust indenture, qualified purchasers sold the Soloso notes to non-qualified purchasers, triggering the violation of ICA registration requirements under §§ 7 and 8.[179]

The Second Circuit acknowledged its previous decision in *Bellikoff v. Eaton Vance Corp.,* where it found no private right of action under a different provision of the ICA.[180] The court applied the same factors used in *Bellikoff*, yet concluded that § 47(b)(2) contained a private right of action for rescission.[181] The three *Bellikoff* factors were: (1) the absence or presence of rights-creating language in the relevant section of the ICA; (2) the explicit enforcement power provided to the SEC in § 42; and (3) the presence of an express private right of action for violations of § 36(b).[182]

The first factor assessed in both *Bellikoff* and *Oxford* was the presence or absence of rights-creating language within the text of the section of the ICA at issue.[183] The *Oxford* court reasoned that the text of § 47(b) itself clearly evinced Congress' intent to provide a private right of action.[184] The opinion compared § 47(b)(1) and (2) and found that paragraph (1) renders "unenforceable by either party" contracts or the performances thereof that violate another section of the ICA;[185] therefore, at the very least, a party sued for nonperformance under such a contract can claim illegality as a defense.[186] Under § 47(b)(2), in relation to contracts that violate the ICA as written or when performed, "a court may not deny rescission at the instance of *any* party."[187] The court opined that § 47(b)(2) necessarily presupposes that if a contract violates the ICA, a party to that contract can

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managing at least $25 million worth of assets; or a company with at least $25 million worth of investments. *See* 15 U.S.C. § 80a–3(c).

177. *Oxford Univ. Bank*, 933 F.3d at 102.
178. *Id.*
179. *Id.* at 103.
180. Bellikoff v. Eaton Vance Corp., 481 F.3d 110 (2d Cir. 2007).
181. *Id.* at 115–18; *Oxford Univ. Bank*, 933 F.3d at 104–07.
182. *Bellikoff*, 481 F.3d at 115–18; *Oxford Univ. Bank*, 933 F.3d at 104–07.
183. *Oxford Univ. Bank*, 933 F.3d at 104; *Bellikoff*, 481 F.3d at 116.
184. *Oxford Univ. Bank*, 933 F.3d at 105.
185. 15 U.S.C. § 80a–46(b)(1) (2019).
186. *Oxford Univ. Bank*, 933 F.3d at 105.
187. *Id.* (citing 15 U.S.C. § 80a–46(b)) (emphasis added).

seek rescission through a court action.[188] Further, the opinion noted that § 47(b)(2) contains a "semi-express" private right of action.[189]

The court's analysis of the language within § 47(b)(2) turned on the *Sandoval* axiom that statutes referencing a particular class of persons tend to create rights.[190] The majority in *Oxford* found that § 47(b)(2) addressed a particular class of persons who stand to benefit from a private right of action—that is, any party to a contract that violates the ICA.[191] The defendant's argument that "any party" only referenced the SEC did not persuade the court because the words "any party" indicate that more than one party may seek rescission.[192] The court opined that sections intended solely for SEC enforcement referenced enforcement by "the Commission."[193] The opinion deduced that different verbiage necessarily implies a party other than the SEC can enforce § 47.[194] Furthermore, when § 47(b)(1) and (2) are read in conjunction with one another, paragraph (2) provides the remedy for unenforceable contracts under paragraph (1).[195]

The second and third factors the court addressed were the existence of another means of enforcement in § 42 and the explicit private right of action found in § 36(b).[196] The *Oxford* court reasoned that the existence of other mechanisms to enforce a statutory provision only "suggests" Congress intended to preclude others.[197] The court explained that the suggestion created by other enforcement mechanisms is overcome where, as in the case of § 47, the meaning of the text is clear.[198]

In addition to refuting the *Bellikoff* factors, the *Oxford* court bolstered its decision with jurisprudence finding an implied private right of action under a similar section of the Investment Advisers Act (IAA), which is considered "companion legislation" to the ICA.[199] Following a line of

188. *Id.*
189. *Id.*
190. *Id.* at 104; Bellikoff v. Eaton Vance Corp., 481 F.3d 110, 116 (2d Cir. 2007); *see* Alexander v. Sandoval, 532 U.S. 275, 288 (2001) (citing California v. Sierra Club, 451 U.S. 287, 294 (1981)).
191. *Oxford Univ. Bank*, 933 F.3d at 105.
192. *Id.*
193. *Id.*
194. *Id.* at 106.
195. *Id.*
196. *Id.*; Bellikoff v. Eaton Vance Corp., 481 F.3d 110, 116 (2d Cir. 2007); 15 U.S.C. § 80a–41(2019).
197. *Oxford Univ. Bank,* 933 F.3d at 106.
198. *Id.* at 101 (citing BedRoc Ltd., LLC v. United States, 541 U.S. 176 (2004)).
199. *Id.* at 106 (citing Transamerica Mortg. Advisors, Inc. (TAMA) v. Lewis, 444 U.S. 11, (1979)).

cases finding private rights of action under similar IAA legislation, Congress amended § 47(b) in 1980, indicating congressional approval of courts finding rights of action under similar types of acts.[200] The opinion then expanded on the bifurcation of § 47 via the 1980 amendments.[201] Prior to the 1980 amendments, § 47 voided contracts made in violation of the ICA; however, the 1980 amendments bifurcated such contracts into unperformed and performed.[202] Section 47(b)(1) indicates unperformed contracts in violation of the ICA cannot be enforced, whereas under § 47(b)(2), performed or partially performed contracts can be rescinded to the extent they have been performed.[203] In essence, § 47(b)(1) prevents parties to illegal contracts from seeking judicial enforcement of the contract. Conversely, § 47(b)(2) contemplates rescission, which requires repayment for partial performance and restoration of each party to their respective precontractual positions.[204]

Further support for a private right of action for rescission under § 47(b)(2) is found in congressional reports.[205] Specifically, the *Oxford* court cited the House committee report accompanying the 1980 amendments.[206] The House committee report explicitly states, "[T]he Committee wishes to make plain that it expects the courts to imply private rights of action under this legislation."[207] The opinion concluded that the committee report shows that the contemporary legal context and the legislative history of § 47(b) strongly support a private right of action for rescission.[208]

The *Oxford* court refuted the *Santomenno* decision when it reasoned that the Third Circuit incorrectly reverted to canons of statutory interpretation when the text of the statute was clear.[209] Finally, the court rejected several district court decisions which held that § 47(b) did not create an implied private right of action because its language "contains a

200. *Id.*
201. *Id.* at 107.
202. *Id.*
203. *Id.*
204. *See Rescission*, BLACK'S LAW DICTIONARY (11th ed. 2019).
205. *See* H.R. REP. NO. 96-1341, at 29 (1980).
206. *Oxford Univ. Bank,* 933 F.3d at 107 (citing H.R. REP. NO. 96-1341, at 29 (1980)). The 1980 amendments created the current iteration of § 47. *See* 15 U.S.C. 80a–46 (2019).
207. *Oxford Univ. Bank*, 933 F.3d at 107 (citing H.R. REP. NO. 96-1341, at 29 (1980)).
208. *Id.* at 108.
209. *Id.*

remedy, but not a substantive right."[210] The *Oxford* court reasoned that if no private right of action for rescission exists under § 47(b)(2), the section is effectively read out of the ICA.[211] Courts concluding no right of action for rescission exists under § 47(b)(2) ignore a central tenet of the Supreme Court's decision in *Sandoval*: interpretation of statutes should center on congressional intent found within the text of the statute.[212]

Although the *Oxford* decision acknowledged a private right of action for rescission under § 47(b)(2), the plaintiffs were denied rescission.[213] The plaintiffs contended the resale of the notes from qualified to non-qualified purchasers violated the ICA and attempted to rescind the indenture based on the illegality of the resale.[214] The plaintiffs were parties to the trust indenture they attempted to rescind; however, neither the terms of the indenture nor its performance violated the ICA.[215] In fact, the language of the trust indenture ensured that non-qualified purchasers could not purchase trust notes.[216] Thus, the plaintiffs may have had a right of action to rescind the contracts between the qualified and non-qualified purchasers because these contracts violated the ICA. However, the plaintiffs could not rescind the trust indenture because the indenture itself did not violate the ICA.[217] The court indicated that if the plaintiffs had brought suit against the resellers of the notes for violating the ICA, then the plaintiffs would have had a claim to rescind the sale contracts.[218]

The *Oxford* decision exhibits convincing evidence of a private right of action for rescission of investment contracts.[219] The decision rebuts the main arguments used to deny private rights of action under § 47(b)(2), and it provides independent proof that a private right of action should exist.[220] Because the *Oxford* opinion recognized a private right of action for rescission but failed to grant it, the opinion compounds the question

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210. *Id.* (citing Smith v. Oppenheimer Funds Distrib., Inc., 824 F. Supp. 2d 511, 519 (S.D.N.Y. 2011); *see also* Smith v. Franklin/Templeton Distribs., Inc., No. C 09-4775, 2010 WL 2348644, at *7 (N.D. Cal. June 8, 2010); Stegall v. Ladner, 394 F. Supp. 2d 358, 378 (D. Mass. 2005).
211. *Oxford Univ. Bank*, 933 F.3d at 108–09.
212. *Id.* at 109 (citing Alexander v. Sandoval, 532 U.S. 275, 286 (2001)).
213. *Id.*
213. *Id.* at 109–10.
214. *Id.* at 109.
215. *Id.* at 110.
216. *Id.* at 109.
217. *Id.*
218. *Id.* at 109–10.
219. *See generally Oxford Univ. Bank*, 933 F.3d 99.
220. *See generally id.*

addressed: if there is a private right of action for rescission under § 47(b)(2), when will it apply? [221]

III: A LIMITED PRIVATE RIGHT OF ACTION UNDER § 47(B)(2)

In *Santomenno*, the Third Circuit interpreted the statutory language of § 47(b) incorrectly, while in *Oxford* the Second Circuit interpreted the statutory language correctly.[222] The language of § 47(b) indicates a private right of action exists, especially when the language is "buttressed"[223] by the Senate and House committee reports relating to the 1970 and 1980 amendments to the ICA.[224] In the wake of the *Oxford* decision, there was concern among lawyers specializing in investment company litigation that a private right of action for rescission could result in increased litigation expense and uncertainty in investment contracts.[225] The risk posed to investment companies also presents a risk to the United States' economic stability.[226]

The risk associated with a private right of action for rescission, however, is limited. Although there may be a slight increase in the amount of litigation surrounding rescission of investment contracts under § 47(b)(2), the circumstances necessary for a plaintiff to bring suit limit the risk of increased litigation expense.[227] Standing requires the plaintiffs to be parties to the contract they seek to rescind or to bring a derivative suit on behalf of the entire investment company if the investment company itself entered into the contract with a third party.[228] In addition, the provisions of § 47 limit the economic harm that could result from a court's grant of rescission.[229] Particularly, courts are given authority to deny rescission on equity grounds under § 47(b)(2), and under § 47(b)(3), courts must limit rescission to the portion of the contract that violates the ICA as written or when performed to the extent the violative portion is

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221. *Id.* at 109.

222. *See generally* Santomenno *ex rel.* John Hancock Tr. v. John Hancock Life Ins., 677 F.3d 178, 181 (3d Cir. 2012); *Oxford Univ. Bank*, 933 F.3d at 109.

223. Alexander v. Sandoval, 532 U.S. 275, 290 (2001).

224. *See generally Oxford Univ. Bank*, 933 F.3d 99.

225. *See generally* Holland et al., *supra* note 1.

226. *See generally* 15 U.S.C. § 80a–1 (2019).

227. *See generally* Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992); PRACTICAL LAW LITIGATION, DISTINGUISHING DIRECT FROM DERIVATIVE CLAIMS (Dec. 15, 2018), Westlaw W-001-0268.

228. *See generally Lujan*, 504 U.S. 555; PRACTICAL LAW LITIGATION, *supra* note 227.

229. *See generally* 15 U.S.C. § 80a–1.

severable.[230] While courts should recognize a private right of action for rescission under § 47(b)(2), courts should also consider the limitations of such a right created by standing, the equity provisions in § 47(b)(2), and the severability clause in § 47(b)(3).[231]

A. A Private Right of Action for Rescission Exists under § 47(b)(2)

Section 47(b)(2) creates a private right of action, as evidenced in the language of the statute itself, and the "contemporary legal context"[232] "buttress[es]" the text of the statute.[233] In *Oxford*, the court pointed to three factors the Second Circuit previously used in *Bellikoff* to deny other private rights of action under the ICA.[234] The considerations were: (1) the relevant section of the ICA did not contain "rights creating language" because it did not confer rights on a particular class of persons;[235] (2) § 42 provided for SEC enforcement of the ICA;[236] and (3) § 36(b) was the exclusive private right of action under the ICA.[237]

The *Oxford* court correctly found that "[t]he text of § 47(b) unambiguously evinces Congressional intent to authorize a private action."[238] Considering the tenets of statutory interpretation established in *Sandoval*, a comparison of the language selected for § 47(b)(1) and (2) is paramount.[239] Section 47(b)(1) renders contracts that violate the ICA "unenforceable by either party."[240] The language in § 47(b)(1) allows a party to raise illegality of contract as a defense to a suit for failure to render performance.[241] To the contrary, § 47(b)(2) states that "a court may not deny rescission at the instance of any party."[242] While paragraph (1) uses

230. *See id.* § 80a–46.
231. *See id.*
232. Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99, 105 (2d Cir. 2019).
232. 15 U.S.C. § 80a–46.
233. Alexander v. Sandoval, 532 U.S. 275, 288 (2001) (citing Thompson v. Thompson, 484 U.S. 174 (1988)).
234. *Oxford Univ. Bank*, 933 F.3d at 104.
235. *Id.* (citing Bellikoff v. Eaton Vance Corp., 481 F.3d 110, 116 (2d Cir. 2007)).
236. *See* 15 U.S.C. § 80a–46.
237. *See id.*
238. *Oxford Univ. Bank*, 933 F.3d at 105.
239. *See Sandoval*, 532 U.S. at 288; 15 U.S.C. § 80a–46.
240. *Oxford Univ. Bank*, 933 F.3d at 104 (citing 15 U.S.C. § 80a–46).
241. *Id.* at 105.
242. 15 U.S.C. § 80a–46.

the term "unenforceable," paragraph (2) uses "rescission."[243] According to *Black's Law Dictionary*, rescission can be used as a remedy or a defense.[244] Paragraph (1) uses the word "unenforceable," indicating that illegality can be used as a defense; therefore, the use of "rescission" in paragraph (2) necessarily indicates an offensive remedial purpose of the word "rescission."[245] If "rescission" is interpreted to have its defensive meaning, § 47(b)(2) would be meaningless in light of § 47(b)(1).[246]

Additionally, § 47(b)(2) states, "[A] court may not deny rescission at the *instance* of any party."[247] The use of the word "instance" is key.[248] According to Merriam-Webster, "instance" means "the institution and prosecution of a lawsuit" or an "instigation, request."[249] It follows that the plain meaning of "instance" indicates a party can institute a lawsuit for rescission of an investment contract that violates the ICA as written or as performed.[250] The language in § 47(b)(2) is "effectively equivalent to providing an express cause of action."[251] Furthermore, § 47(b)(2) indicates a particular party has the right to sue for rescission—*any* party to an illegal contract.[252]

The authority to enforce the ICA granted to the SEC in § 42 does not preclude a private right of action under § 47(b)(2).[253] Other methods of enforcement only suggest congressional intent to preclude implied private rights of action.[254] The text of § 47(b)(2) overcomes this suggestion because the text clearly indicates a party to a contract made in violation of or the performance of which violates the ICA can seek rescission.[255]

Evidence surrounding the 1970 and 1980 amendments indicates that Congress did not intend § 36(b) to be the exclusive private right of action under the ICA.[256] The 1970 amendment is relevant because it created the

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243. *Id.*
244. *Rescission*, BLACK'S LAW DICTIONARY (11th ed. 2019).
245. *See Oxford Univ. Bank*, 933 F.3d at 105.
246. *See id.* at 109.
247. 15 U.S.C. § 80a–46 (emphasis added).
248. *Id.*
249. *Instance*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/instance [https://perma.cc/YF29-9NHX] (last visited Dec. 20, 2020).
250. *Id.*
251. *See* S. REP. NO. 91-184 (1970); H.R. REP. NO. 96-1341, at 29 (1980).
252. Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99, 106 (2d Cir. 2019).
253. *Id.*
254. *Id.*
255. *Id.* at 101 (citing BedRoc Ltd., LLC v. United States, 541 U.S. 176 (2004)).
256. *See* Knickle, *supra* note 29.

express private right of action under § 36(b), while the 1980 amendment is vital because Congress changed § 47(b) to include two paragraphs, (1) and (2).[257] Paragraph (1) speaks of unenforceability of violative contracts, while paragraph (2) speaks of rescission of violative contracts.[258] Congressional committee reports surrounding both amendments support the premise that § 36(b)'s express private right of action was not intended to preclude other private rights of action.[259]

Pursuant to the 1970 amendments to the ICA, which created a private right of action under § 36(b), the Senate committee report regarding the amendments states that Congress did not enact § 36(b) to stop courts from finding implied rights of action under other sections of the ICA.[260] The Senate committee report established unequivocal proof: Congress did not intend § 36(b) to preclude other rights of action under other sections of the ICA.[261] Congress amended the ICA again in 1980.[262] A House committee report pertaining to the amendment states that "the Committee wishes to make it plain that it expects the courts to imply private rights of action under the legislation."[263] Congress did not intend to prevent courts from finding private rights of action under either the amendment that created § 36(b)—the section courts rely upon to deny private rights of action in other sections of the ICA—or the amendment that created the current language of § 47(b).[264] In fact, the reports acknowledge both that Congress enacted legislation within a judicial context that included implied rights of action under various sections of the ICA and that Congress did not intend the addition of § 36 and the bifurcation of § 47 to block rights of action under other sections of the ICA.[265]

Although *Sandoval* held that it is impossible to extrapolate congressional approval of judicial interpretation in light of isolated amendments to legislation, the reasoning of the *Sandoval* Court is

257. *Oxford Univ. Bank,* 933 F.3d at 107.
258. *See* 15 U.S.C. § 80a–46 (2019).
259. *See Oxford Univ. Bank,* 933 F.3d at 107.
260. Fogel v. Chestnutt, 668 F.2d 100, 111 (2d Cir. 1981) (citing H.R. REP. NO. 96-1341, at 29 (1980)).
261. *See* S. REP. NO. 91-184 (1970).
262. *See* 15 U.S.C. § 80a–46.
263. *See* H.R. REP. NO. 96-1341, at 29 (1980).
264. *See Fogel*, 668 F.2d at 111; *Oxford Univ. Bank*, 933 F.3d at 107.
265. *See generally* S. REP. NO. 91-184 (1970); H.R. REP. NO. 96-1341, at 29 (1980).

inapplicable to the 1970 and 1980 amendments to the ICA.[266] The Senate and House committee reports surrounding the 1970 and 1980 amendments make it possible to determine that Congress approved of the judiciary's interpretation of the ICA.[267] Both committee reports expressly state that Congress intended courts to find private rights of action in sections of the ICA other than § 36(b).[268] Furthermore, the *Sandoval* decision did not completely preclude the use of the contemporary-legal-context principle.[269] The *Sandoval* Court approved the use of contemporary-legal-context theory when it "simply buttressed a conclusion independently supported by the text of the statute."[270] Specifically, the *Sandoval* Court opined, "We have never accorded dispositive weight to context shorn of text. . . . [L]egal context matters only to the extent it clarifies text."[271] As expressed above, the text of § 47(b)(2) clearly indicates congressional intent to create a private right of action for rescission of contracts in violation of the ICA.[272] It follows that the use of the Senate and House committee reports is acceptable to buttress the text supporting a private right of action for rescission under § 47(b)(2).[273]

B. Limits to the Private Right of Action under § 47(b)(2)

Although the scope of § 47(b)(2) is seemingly broad in that it provides for a private right of action for rescission to any party to an illegal contract, the risk posed to investment companies is relatively low.[274] Standing requirements greatly reduce the instances under which private plaintiffs can bring suit for rescission; therefore, the scope of potential plaintiffs is reduced to those who are parties to the violative contract and those who

266. *See* Alexander v. Sandoval, 532 U.S. 275, 292 (2001) (quoting Patterson v. McLean Credit Union, 491 U.S. 164, 175 (1989)). *But see* S. REP. NO. 91-184 (1970); H.R. REP. NO. 96-1341, at 29 (1980).

267. *See Sandoval*, 532 U.S. at 292 (quoting Patterson v. McLean Credit Union, 491 U.S. 164, 175 (1989)). *But see* S. REP. NO. 91-184 (1970); H.R. REP. NO. 96-1341, at 29 (1980).

268. *See generally* S. REP. NO. 91–184 (1970); H.R. REP. NO. 96–1341, at 29 (1980).

269. *Sandoval*, 532 U.S. at 290.

270. *Id.* at 288.

271. *Id.*

272. Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99, 105 (2d Cir. 2019).

273. *See Sandoval*, 532 U.S. at 288.

274. *See* Holland et al., *supra* note 1.

can bring derivative suits on behalf of all shareholders.[275] Furthermore, the equity provisions in § 47(b)(2) and the severability provision in § 47(b)(3) greatly reduce the risk of economic harm that could result from rescission.[276]

1. Standing in General

Standing is a person's right to seek relief in court.[277] Standing ensures that the plaintiff has a personal interest in the case and that the parties are adversarial.[278] There are two ways an investor may have standing to seek rescission under § 47(b)(2).[279] First, an investor has standing if the investment contract violates the ICA or if the performance of one of the stipulations within the investment contract causes an ICA violation.[280] If the ICA violation arises from the investment contract, the investor can bring a direct claim against the investment company, the investment adviser, or the investment company's board of directors.[281] Second, an investor has standing if the investor brings a derivative suit on behalf of the investment company.[282] Direct claims allege the defendants harmed the individual shareholders, whereas derivative claims assert the defendants harmed the company as a whole.[283] The plaintiffs in a derivative action bring the claim on behalf of the corporation when the corporation refuses to bring suit or when demanding suit is futile.[284] The law of the state under which an investment company is incorporated determines whether a direct or a derivative suit must be brought.[285] In most states, jurisprudentially established standing rules require the plaintiff in a direct action to have suffered harm distinct from the harms suffered by the

275. *See generally* Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992); PRACTICAL LAW LITIGATION, *supra* note 227.

276. 15 U.S.C. § 80a–46 (2019).

277. *See generally Lujan*, 504 U.S. at 561. Three criteria are needed to show standing. First, there must exist an injury in fact to a legally protected interest. The damage must be concrete and not speculative in nature. Second, a causal nexus between the alleged injury and the conduct of the defendant must exist. Finally, a favorable judgment must be likely to remedy the damage inflicted. *Id.*

278. *Id.*

279. *See generally* Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99 (2d Cir. 2019).

280. *See generally id.*

281. *See generally* Hamilton v. Allen, 396 F. Supp. 2d 545 (E.D. Pa. 2005).

282. *See generally id.*

283. PRACTICAL LAW LITIGATION, *supra* note 227.

284. *Id.*

285. *Hamilton*, 396 F. Supp. 2d at 549.

corporation as a whole.[286] Individual plaintiffs must show that the defendant owed a duty to the plaintiff and that the plaintiff can succeed without showing harm to the corporation.[287] The requirement that the plaintiff must succeed without showing harm to the corporation is integral to individual lawsuits for rescission of contracts under § 47(b)(2). An individual investor is more likely to show that he was harmed without showing the investment company itself was harmed if the investor, not the investment company, was a party to the contract. In essence, individual investors suing on their own behalf have standing only if they can show a harm distinct from the harms that the investment company suffered as a whole. A plaintiff can overcome the standing requirement if the plaintiff is a party to the contract that violates the ICA.[288]

In *Hamilton v. Allen*, the United States District Court for the Eastern District of Pennsylvania's decision embodied the restrictions standing places on private plaintiffs seeking rescission under § 47(b)(2).[289] In *Hamilton*, the plaintiffs were two private investors who filed a class action "on behalf of themselves and all others similarly situated."[290] The plaintiffs alleged the investment advisers failed to include the fund investors in hundreds of securities class action lawsuits, thereby causing financial loss to all investors in the mutual fund.[291] Because of this failure, the plaintiffs sought rescission of the advisory contracts entered into between the mutual fund's board of directors and the investment advisers under § 47(b).[292] The plaintiffs alleged the performance of the advisory contracts violated § 36(a) and (b) of the ICA.[293]

The court analyzed the plaintiffs' standing and determined that the plaintiffs did not have standing to bring the claim.[294] The claim was derivative in nature because the officers and directors of the mutual fund breached their fiduciary duty, harming all investors in the fund, not just one specific class of investors.[295] Massachusetts law, which was

286. PRACTICAL LAW LITIGATION, *supra* note 227.

287. Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1039 (Del. 2004).

288. PRACTICAL LAW LITIGATION, *supra* note 227.

289. *Hamilton*, 396 F. Supp. 2d 545.

290. *Id.* at 548. The claim was a direct action, not a derivative action, because the plaintiffs brought a class action suit on behalf of all similarly situated investors and not on behalf of the corporation itself.

291. *Id.*

292. *Id.*

293. *Id.*

294. *Id.* at 559–60.

295. *Id.* at 551.

controlling in this case, stated that if the alleged wrong harms the plaintiffs merely as owners of corporate stock, then the harm is derivative in nature.[296] *Hamilton* exhibits a key principle that several courts have previously echoed: either the plaintiff must be a party to the contract, or the plaintiff must bring a derivative suit on behalf of the fund to have standing.[297] The plaintiffs were not parties to the advisory contracts at issue, and they did not bring a derivative claim on behalf of all shareholders; therefore, the plaintiffs did not have standing to bring claims under the ICA.[298] If the plaintiffs would have brought a derivative suit, the court would not have dismissed the claim.[299] Because it is unlikely the board of directors would sue the investment advisers, the derivative claim would have been one in which demanding the board of directors bring suit on behalf of the corporation was futile.[300] In this case, it is unlikely that the board would have sued the investment adviser on behalf of the harms the investment adviser inflicted upon the company and its investors; therefore, a derivative suit likely would have been warranted under these facts.

2. Practical Implications of Standing

Standing greatly restricts the class of plaintiffs who can bring a private right of action for rescission under § 47(b)(2). Under § 47(b)(2), private investors may only seek rescission for violations of the ICA either contained within the investment agreements they sign with investment companies or for violations of the ICA that occur when the terms of the agreement are carried out.[301] For example, a mutual fund investor can only seek rescission based on a provision within the prospectus that violates or

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296. *Id.* at 550.

297. *Id.* at 558; *see also* Lessler v. Little, 857 F.2d 866, 874 (1st Cir. 1988). In *Lessler*, the court opined as follows:

> Lessler is not a party to the Narragansett-Monarch contract, nor does his complaint assert a derivative action on behalf of Narragansett, which is a party. Lessler proceeds solely on his own behalf as a shareholder and on behalf of others similarly situated. As our previous decisions have made clear, a shareholder such as Lessler lacks the standing to pursue on his own claims properly belonging to the corporation.

Lessler, 857 F.2d at 874; *see also In re* Regions Morgan Keegan Secs., Derivative, & ERISA Litig., 743 F. Supp. 2d 744, 762 (W.D. Tenn. 2010).

298. *Hamilton*, 396 F. Supp. 2d at 558.

299. *See id.*

300. *See generally Hamilton*, 396 F. Supp. 2d 545.

301. *See supra* note 297.

causes a violation of the ICA.[302] The prospectus is the root from which a private right of action for rescission stems; therefore, an exploration of the contents of a normal prospectus will solidify the types of ICA violations that could lead to the rescission of an investment contract. Legally, a mutual fund prospectus must contain a mutual fund's investment objectives, investment strategies, investment risks, past performance, distribution policy, fees and expenses, and fund management information.[303]

The investment objectives are the financial goals of the fund.[304] The financial goals of the fund should determine the investments chosen to achieve the outlined fund goals.[305] Investment strategies speak to the method the fund uses to allocate and manage its resources to achieve its investment objectives.[306] The risk of investing affirmatively states the level of risk associated with a fund as determined by the riskiness of the stock chosen.[307] The past performance section shows the mutual fund's economic performance in prior years.[308] The distribution policy explains how investors receive payment from the fund in various forms such as capital gains, interest, and dividends, to name a few.[309] Furthermore, the prospectus addresses the fees and expenses the fund charges.[310] The fees and expenses section includes fees charged under § 12(b)(1), which covers distribution, marketing, and fund servicing.[311] Section 12(b)(1) fees pay for marketing and brokers who sell the shares.[312] Covered in the section on fees and expenses are the fees paid to investment advisers.[313] Finally, the prospectus provides information regarding fund management, such as information about the investment adviser of the mutual fund.[314] If the alleged ICA violation does not arise out of the prospectus' terms or the performance of those terms, then a court will not grant rescission unless

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302. The prospectus is the legally binding contract between the mutual fund and the fund holder. Heyford, *supra* note 10.

303. *Id.*

304. *Id.*

305. *Id.*

306. *Id.*

307. *Id.*

308. Past performance is not an indication of future performance. *Id.*

309. *Id.*

310. *Id.*

311. *Id.*

312. *Id.*

313. Adam Hayes, *Expense Ratio Definition*, INVESTOPEDIA, https://www.investopedia.com/terms/e/expenseratio.asp [https://perma.cc/DK6G-JCQ8] (last updated July 9, 2020).

314. Heyford, *supra* note 10.

the private investor brings a derivative suit on behalf of the company.[315] Standing restricts the ability of individual plaintiffs to seek rescission of contracts other than the prospectus because the investors are not parties to such contracts.

To illustrate a case in which a private right of action for rescission could occur, recall the hypothetical involving Jordan Belfort, the investment adviser of a mutual fund, and Chester, Donnie, and Nicky—the investors.[316] In that example, the financial goals in the prospectus were conservative with modest, long-term objectives. Thus, the decision to invest in S&P 500 stocks matched the prospectus' objectives. Jordan's subsequent poor decision to invest in risky penny stocks for a quick short-term gain did not match the fund objectives of modest, long-term growth. Jordan violated the terms of the prospectus and exposed the fund investors to extreme risk for the self-serving purpose of increasing his salary, which is directly tied to the performance of the fund. In this case, Chester, Donnie, and Nicky are parties to the prospectus, and Jordan has violated § 36(a) of the ICA.[317] Jordan has breached the fiduciary duty he owed to the mutual fund investors for a self-serving purpose. As a result of the breach of fiduciary duty, Chester, Donnie, and Nicky have suffered harm—Jordan has squandered the money they invested. Under this scenario, Chester, Donnie, and Nicky would have standing to bring a suit for rescission of their investment contracts under § 47(b)(2) of the ICA.[318]

3. Equity and Severability Restrictions

In addition to the standing restriction, § 47(b)(2) states that "a court may not deny rescission . . . 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."[319] Section 47(b)(2) grants courts the power to decide if rescission of investment contracts is equitable under the circumstances, provided the denial of rescission is consistent with the purpose of the ICA.[320] Recall that the purpose of the ICA as set forth in the findings and

315. *See supra* note 297; *see also In re* Regions Morgan Keegan Secs., Derivative, & ERISA Litig., 743 F. Supp. 2d 744, 762 (W.D. Tenn. 2010).

316. *See supra* Introduction.

317. Heyford, *supra* note 10.

318. 15 U.S.C. § 80a–46 (2019). *See generally* Hamilton v. Allen, 396 F. Supp. 2d 545 (E.D. Pa. 2005); Lessler v. Little, 857 F.2d 866, 874 (1st Cir. 1988); *In re Regions Morgan Keegan Secs.*, 743 F. Supp. 2d at 762.

319. 15 U.S.C. § 80a–46.

320. *See id.*

declaration of policy section is to address the fraud and mismanagement in the investment company industry with a particular focus on the conflict of interest inherent in the relationship between the investment adviser and mutual fund.[321] The court should look to whether the ICA violation amounted to mismanagement and fraud or whether the violation was incidental or clerical.[322] The ICA seeks to eliminate mismanagement and fraud within investment companies; therefore, technical violations of the ICA will generally not lead to rescission on equity grounds. [323]

Finally, § 47(b)(3) restricts private causes of action for rescission to the unlawful portion of the contract to the extent the contract is severable.[324] In pertinent part § 47(b)(3) states, "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 . . . ."[325] If the contract can be severed, only the section of the investment contract that violates the ICA will be rescinded.[326] State law governs the severability of contractual provisions.[327] Although state law varies somewhat regarding the severability of contracts, a contract provision is generally severable if the contract provides for multiple promises, each of which are separately enforceable, such that failure of one of the promises does not cause the breaching party to breach the entire contract.[328] Section 47(b)(3) reduces the financial risk rescission poses to investment companies because courts should restrict rescission to the section of the investment contract that violates the ICA.[329] Ultimately, the rescission of the entire investment contract is unlikely.

CONCLUSION

Section 47(b)(2) provides investors with a private right of action for rescission when the contract they sign or the performance thereof violates the ICA, whether it is a mutual fund prospectus or a trust indenture.[330] Although mutual fund directors and investment advisers may view this

321. *See Lessler*, 857 F.2d at 870.
322. *See* 15 U.S.C. § 80a–46.
323. *See id.* § 80a–1.
324. *Id.* § 80a–46.
325. *Id.*
326. *Id.*
327. *See* Kamen v. Kemper Fin. Servs., 500 U.S. 90 (1991).
328. *Severable Contract*, BLACK'S LAW DICTIONARY (11th ed. 2019).
329. *See generally* 15 U.S.C. § 80a–46.
330. Oxford Univ. Bank v. Lansuppe Feeder, LLC, 933 F.3d 99, 107 (2d Cir. 2019); *see* 15 U.S.C. § 80a–46; Heyford, *supra* note 10.

outcome as detrimental to the funds and investments they manage, the overall increase in risk to investment companies is minimal because of several key factors.[331] A private plaintiff only has standing if the investment contract itself violates the ICA, or if the plaintiff brings a derivative action on behalf of the investment company.[332] Additionally, the equity provision in § 47(b)(2) and the severability provision in § 47(b)(3) both reduce the economic risks rescission poses to investment companies.[333] The limitations provided within the statute suggest Congress contemplated the potential damage that widespread rescission of investment contracts posed to investment companies and to the overall health of the U.S. economy when they created § 47. Section 47's provisions both limit rescission when rescission would produce an inequitable result and restrict rescission to the portion of the contract that violates the ICA.[334]

Recognizing a private right of action for rescission under § 47(b)(2), with its limitations in mind, adheres to the purpose of the ICA.[335] Recognition of a private right of action for rescission protects investors in the face of inherent conflicts of interest between investment advisers and the funds they manage, and such protection is a core tenet of the ICA.[336] Furthermore, the interests of a stable economy are protected through the limitations placed on such a cause of action.

331. *See* 15 U.S.C. § 80a–46.
332. *See id.*
333. *Id.*
334. *Id.*
335. *Id.* § 80a–1.
336. *Id.*