

Other Significant Circuit Court Decisions

12.23.19



(Article from *Securities Law Alert, Year in Review 2019*)

For more information, please visit the [Securities Law Alert Resource Center](#)

Second Circuit: Creates a Circuit Split by Holding That Section 47(b) of the Investment Company Act Provides a Private Right of Action

On August 5, 2019, the Second Circuit held that Section 47(b) of the Investment Company Act (“ICA”) “creates an implied private right of action for a party to a contract that violates the ICA to seek rescission of that violative contract.” [Oxford University Bank v. Lansuppe Feeder](#), 933 F.3d 99 (2d Cir. 2019) (Leval, C. J.). The Second Circuit expressly disagreed with the Third Circuit’s decision in *Santomenno ex rel. John Hancock Trust v. John Hancock Life Ins. Co.*, 677 F.3d 178 (3d Cir. 2012), which held that there is no private right of action under Section 47(b) of the ICA.

Section 47(b) of the ICA provides in relevant part as follows:

Validity of Contracts

- (1) A contract that is made, or whose performance involves, a violation of this subchapter . . . is unenforceable by either party . . .
- (2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny rescission at the instance of any party unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of this subchapter.

15 U.S.C. § 80a-46(b).

The Second Circuit found that “[a]lthough Congress did not expressly state [in Section 47(b)(2)] that a party to an illegal contract may sue to rescind it, the clause that begins ‘a court may not deny rescission at the instance of any party’ necessarily presupposes that a party may seek rescission in court by filing suit.” The court concluded that “[t]he language Congress used is thus effectively equivalent to providing an express cause of action.” The Second Circuit found that “§ 47(b)(2) also identifies a ‘class of persons’ who benefit from the availability of the right of action.” The court reasoned that “[t]he most natural reading of the clause providing for rescission, which appears in a section entitled ‘Validity of Contracts’ and provides a remedy that benefits a party to an illegal contract, is that ‘any party’ refers to parties to a contract whose

provisions violate the ICA.”

The Second Circuit stated that it “respectfully disagree[d]” with the Third Circuit’s decision in *Santomenno*, 677 F.3d 178, because the Third Circuit “relied on interpretive canons that are intended to help resolve ambiguity” rather than “focusing on the text of the statute.” The Second Circuit noted that “the Third Circuit failed to mention the strongest textual indication of Congressional intent to provide a private right of action: the clear language of § 47(b)(2) that ‘a court may not deny rescission *at the instance of any party.*’”

Eighth Circuit: Omitting Projected Net Income/Loss Information May Render a Proxy Statement Materially Misleading in Violation of Section 14(a) and Rule 14a-9

On March 1, 2019, the Eighth Circuit reversed the dismissal of a securities fraud action alleging that a company’s proxy statement in connection with a proposed merger was materially misleading in violation of Section 14(a) of the Securities Exchange Act of 1934 (“Exchange Act”) and SEC Rule 14a-9, where the proxy statement failed to disclose projected net income/loss information for the pre-merger target company. [*Campbell v. Transgenomic*, 916 F.3d 1121 \(8th Cir. 2019\) \(Benton, C.J.\)](#). The court reasoned that “projected net income/loss is not trivial information” and “may be of more significance to investors than revenue.”

The Eighth Circuit stated that, for purposes of SEC Rule 14a-9, “[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.” The court noted that “[u]nder this test it is not necessary to prove that disclosure of an omitted fact would have caused a reasonable investor to change his decision.” The court underscored that “[d]oubts as to the critical nature of information misstated or omitted” should be “resolved in favor of those [SEC Rule 14a-9] is designed to protect.”

In the case before it, the Eighth Circuit found that the pre-merger company’s net income/loss figures were particularly relevant because the proxy statement included gross profit projections for the pre-merger company. The court determined that “[b]y omitting the (allegedly) significantly lower projections for [the company’s] net income/ loss, the proxy statement may have presented [the company] in a false light that was materially misleading.”

Tenth Circuit: Pursuant to Section 929P(b) of the Dodd-Frank Act, the Conduct and Effects Tests Govern the Extraterritorial Reach of SEC Enforcement Actions

On January 24, 2019, the Tenth Circuit held that the conduct and effects tests codified in Section 929P(b) of the Dodd-Frank Act govern the extraterritorial reach of SEC enforcement actions brought under Section 10(b) of the Exchange Act and Section 17(a) of the Securities Act. [*SEC v. Scoville*, 913 F.3d 1204 \(10th Cir. 2019\) \(Ebel, C.J.\)](#). Enacted less than a month after the Supreme Court’s decision in *Morrison v. National Australia Bank*, 561 U.S. 247 (2010), Section 929P(b) amended the securities laws to provide that district courts have jurisdiction over extraterritorial SEC enforcement actions brought under Section 10(b) of the Exchange Act or Section 17(a) of the Securities Act if the conduct and effects tests are met.^[1]

Although Section 929P(b) addressed “the jurisdictional provisions of the securities acts,” the Tenth Circuit determined that “Congress undoubtedly intended that the substantive antifraud provisions should apply extraterritorially” in SEC enforcement actions “when the statutory conduct and-effects test is satisfied.” The Tenth Circuit based this conclusion on “the context and historical background surrounding Congress’s enactment of those amendments,” including the title of Section 929P(b), *Strengthening Enforcement by the Commission*.

^[1] In *Morrison*, the Supreme Court found that the extraterritorial reach of Section 10(b) is a merits question rather than a jurisdictional question. The Court repudiated the conduct and effects tests, and instead held that Section 10(b) applies only to “transactions in securities listed on domestic exchanges, and domestic transactions in other securities.” 561 U.S. 247.

Authors and Contacts

Paul Gluckow

Partner and General Counsel

pgluckow@stblaw.com

+1-212-455-2653

Jonathan Youngwood

Partner

jyoungwood@stblaw.com

1-212-455-3539

Peter Kazanoff

Partner

pkazanoff@stblaw.com

+1-212-455-3525

