

MEMO# 34045

February 22, 2022

Federal Court Holds that Closed-End Funds' Control Share Provisions are Impermissible

[34045]

February 22, 2022

TO: ICI Members

Investment Company Directors SUBJECTS: Closed-End Funds

Fund Governance RE: Federal Court Holds that Closed-End Funds' Control Share Provisions are Impermissible

The US District Court for the Southern District of New York last week held that certain closed-end funds' "control share" provisions impermissibly violate the Investment Company Act of 1940.[\[1\]](#) A control share provision generally restricts the rights of a shareholder who owns more than a certain percentage of a company's shares from voting those shares, unless other shareholders restore those rights. Approximately half of the states (e.g., Maryland) have adopted state control share statutes incorporating control share provisions into their laws to protect all shareholders from coercion in proposed tender offers and changes in control. The District Court decision could impact several closed-end funds that have either opted-in to state control share statutes or adopted control share provisions in their governing documents.

Background

In 2010, a closed-end fund requested SEC staff input as it considered opting-in to a state control share statute. In response to the request, the SEC staff issued a no-action letter, The Boulder Total Return Fund, Inc., determining that opting-in to the statute would be inconsistent with the requirement in Section 18(i) of the Investment Company Act that every share of stock issued by a fund be "voting stock" and have "equal voting rights" with every other outstanding voting stock.[\[2\]](#)

In 2020, the SEC staff issued a statement withdrawing the Boulder letter and reversing the SEC staff's previous position that funds opting-in to state control share statutes are acting inconsistent with the Investment Company Act.[\[3\]](#) The staff's actions followed ICI advocacy urging the Commission or its staff to permit funds to opt-in to state control share statutes and to issue guidance on the defenses that closed-end funds and their independent directors may use to defend against activist campaigns.[\[4\]](#)

Since the issuance of the staff statement, several closed-end funds have either opted-in to state control share statutes (e.g., if the fund's state of incorporation has enacted a state control share statute) or adopted control share provisions in their governing documents that mirror state control share statutes.

In 2021, Saba Capital CEF Opportunities 1, LTD sued certain closed-end funds alleging, among other things, that their adoption of a control share provision violated Section 18(i) of the Investment Company Act.

Decision

The District Court decision held that the funds' control share provisions violate Section 18(i) of the Investment Company Act requiring that every share of stock "be a voting stock and have equal voting rights with every other outstanding voting stock."^[5] Although "voting stock" is not defined under the Investment Company Act, the court looked principally at the definition of "voting security" under the Act, which is defined as "any security presently entitling the owner or holder thereof to vote for the election of directors of a company."^[6] The court reasoned that when a shareholder acquires new stock in one of the funds, and the amount of her stock constitutes a control share, her newly acquired stock does not presently entitle her to vote. Instead, her vote is contingent on whether the holders of the majority of stock, excluding stock owned by control shareholders, authorize it. Thus, it held that the Investment Company Act makes the contingency impermissible.^[7]

In making the determination, the District Court, among other things, found the SEC staff's withdrawal of the Boulder letter to be unavailing. It noted that the withdrawal by its own terms "had no legal force or effect" and, unlike the Boulder letter, did not contain any legal analysis of Section 18(i).^[8]

Kenneth Fang
Associate General Counsel

endnotes

^[1] See Saba Capital CEF Opportunities 1, LTD v. Nuveen Floating Rate Income Fund, No. 21-CV-327 (JPO) (D. SDNY filed Feb. 17, 2022) ("opinion"). The opinion is attached to this memo.

^[2] See Boulder Total Return Fund, Inc. (pub. avail. Nov. 15, 2010) ("Boulder letter"), available at www.sec.gov/divisions/investment/noaction/2010/bouldertotalreturn111510.htm.

^[3] See SEC Division of Investment Management, Control Share Acquisition Statutes (May 27, 2020) ("staff statement"), available at www.sec.gov/investment/control-share-acquisition-statutes. For a summary of the staff statement, please see ICI Memorandum No. 32487, available at www.ici.org/my_ici/memorandum/memo32487.

^[4] See, e.g., ICI, Recommendations Regarding the Availability of Closed-End Fund Takeover Defenses (Mar. 2020), available at https://www.ici.org/pdf/20_ltr_cef.pdf.

^[5] See Section 18(i) of the Investment Company Act.

[6] See Section 2(a)(42) of the Investment Company Act (emphasis added).

[7] See opinion at 4-5.

[8] See opinion at 6-7.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.