

MEMO# 34242

August 4, 2022

Delaware Adopts Amendments to Protect Long-Term Closed-End Fund Shareholders

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TO: ICI Members

Investment Company Directors SUBJECTS: Closed-End Funds RE: Delaware Adopts Amendments to Protect Long-Term Closed-End Fund Shareholders

Last week, the State of Delaware adopted amendments to its Delaware Statutory Trust Act that, among other things, automatically subjects registered closed-end funds and business development companies traded on a national securities exchange or on the National Association of Securities Dealer Automated Quotation System (NASDAQ) and organized as Delaware statutory trusts (together, "funds") to "control share" provisions.^[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 ("control shares"), unless the other non-interested shareholders restore those rights. This memo provides background on control share provisions, then briefly summarizes the amendments.

Background

Control share provisions function as anti-takeover devices. Since the SEC staff withdrew guidance prohibiting closed-end funds from employing them in 2020,^[2] many closed-end funds have opted into state control share statutes^[3] or have adopted control share provisions in their own governing documents. Over the last year, activist shareholders have challenged the ability of closed-end funds to rely on control share provisions, asserting that they violate Section 18(i) of the Investment Company Act of 1940.^[4] Section 18(i) states that "[e]xcept . . . as otherwise required by law, every share of stock [issued by, among others, a closed-end fund] shall be a voting stock and have equal voting rights with every other outstanding voting stock." Although "voting stock" is not defined under the Investment Company Act, the Act defines a "voting security" to mean "any security presently entitling the owner or holder thereof to vote for the election of directors of a company."^[5] Thus, the activist shareholders assert that control share provisions violate Section 18(i) by restricting the control shares from presently entitling their owners or holders to vote and from not providing their owners and holders with equal voting rights with other outstanding shares.^[6]

The amendments address these Investment Company Act concerns by applying Delaware's control share statute automatically to all funds rather than allowing those funds to opt into it, and by clearly imposing the restrictions on shareholders not the shares. Subjecting all funds to the amendments without option enables the funds to rely on the "unless otherwise required by law" exception to the Section 18(i) requirements. In addition, applying the restrictions specifically to shareholders rather than on the shares appears intended to avoid claims that the amendments impermissibly place restrictions on the shares in violation of Section 18(i).

Summary of the Amendments

The amendments create a new subchapter to the Delaware Statutory Trust Act ("DSTA") that restricts a shareholder who acquires "control beneficial interests" of a Delaware statutory trust above certain thresholds from voting those shares unless two-thirds of the shares entitled to vote on the matter (exclusive of those shares held by certain interested persons) vote to restore those rights.[\[7\]](#) The amendments define "control beneficial interests" to mean beneficial interests that, but for the new subchapter, when aggregated with all of a person's other shares (including generally those that the person has voting power over) would entitle the person to exercise or direct the exercise of voting power in the election of trustees within any of the following ranges:

- 10 percent or more, but less than 15 percent of all voting power;
- 15 percent or more, but less than 20 percent of all voting power;
- 20 percent or more, but less than 25 percent of all voting power;
- 25 percent or more, but less than 30 percent of all voting power;
- 30 percent or more, but less than a majority of all voting power; or
- a majority or more of all voting power.[\[8\]](#)

Each time one of these thresholds is crossed, the amendments would restrict an acquiring shareholder from voting the acquired control beneficial interests unless the other non-interested shareholders have voted to restore those rights.[\[9\]](#)

Acquiring shareholders must disclose to a fund any acquisition of a control beneficial interest within 10 days of the acquisition.[\[10\]](#) A fund then may require the acquiring shareholder or an associate of such person to disclose the number of beneficial interests owned or with respect to which such person or an associate thereof has voting power over.[\[11\]](#)

A shareholder who acquires or proposes to acquire shares that cross or would cross one of the thresholds may request a special meeting of shareholders to consider restoring its voting rights.[\[12\]](#)

As stated above, funds cannot opt out of the amendments, however, fund boards can except specific acquisitions or types of acquisitions from the requirements through an amendment to a fund's governing document or by specific board action.[\[13\]](#) In addition, the amendments clarify that the restriction applies to shareholders not the shares, specifically noting that such beneficial interests have voting rights when transferred from a restricted shareholder to another shareholder, unless the acquisition of such beneficial interests constitutes an acquisition of control beneficial interests.[\[14\]](#)

The amendments became effective on August 1, 2022, and only apply to acquisitions that occur after that date (though shares acquired before that date will be aggregated with all other shares to determine whether the acquiring shareholder crosses one of the thresholds

above).

Kenneth Fang
Associate General Counsel

endnotes

[1] See AN ACT TO AMEND CHAPTER 38, TITLE 12 OF THE DELAWARE CODE RELATING TO THE CREATION, REGULATION, OPERATION, AND DISSOLUTION OF DOMESTIC STATUTORY TRUSTS, Senate Bill No. 284 with House Amendment No. 1 (Signed into Law on July 27, 2022), available at <https://legis.delaware.gov/BillDetail?LegislationId=109453>.

[2] See SEC Division of Investment Management, Control Share Acquisition Statutes (May 27, 2020), available at <https://www.sec.gov/investment/control-share-acquisition-statutes>. For a summary of the staff's withdrawal letter, see ICI Memorandum No. 32487, available at <https://www.ici.org/memo32487>.

[3] 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.

[4] See, e.g., Saba Capital CEF Opportunities 1, LTD v. Nuveen Floating Rate Income Fund, No. 21-CV-327 (JPO) (D. SDNY Feb. 17, 2022) ("Nuveen case"); Eaton Vance Senior Income Trust v. Saba Capital Master Fund, Ltd., 2084CV01533-BLS2 (Mass. Super. Ct. Mar. 31, 2021).

[5] See Section 2(a)(42) of the Investment Company Act.

[6] The District Court in the Nuveen case agreed with these activist shareholders' assertions, holding that the subject funds' control share provisions violate Section 18(i) of the Investment Company Act. It 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. Thus, it held that the Investment Company Act renders the funds' control share provisions impermissible. For a summary of the District Court opinion, see ICI Memorandum No. 34045, available at <https://www.ici.org/memo34045>. The subject funds in the Nuveen case currently are appealing the District Court ruling, and ICI has submitted an amicus curiae ("friend of the court") brief supporting the funds. For a summary of the amicus brief, see ICI Memorandum No. 34188, available at <https://www.ici.org/memo34188>.

[7] The subchapter (Subchapter III. Control Beneficial Interest Acquisitions) is attached as Appendix A to this memo and adds new Sections 3881 to 3888 to the DSTA.

[8] See DSTA Section 3881(e)(1). The definition contains an exception for broker-dealers

and other members of a national securities exchange who will not be deemed beneficial owners of beneficial interests solely because the member is the recordholder of such securities and may direct the vote of such interests, without instructions, on routine matters pursuant to the rules of the exchange. Id.

[9] See DSTA Section 3883(a). Those control beneficial interests also would not be considered outstanding with regard to determining quorum or for any other matters relating to voting. Id. The amendments provide certain exceptions to the restrictions, including generally for mergers or consolidations in which the fund is the survivor.

[10] See DSTA Section 3888(a).

[11] Id.

[12] See DSTA Section 3885.

[13] See DSTA Section 3883(b).

[14] See DSTA Section 3883(a) ("Upon transfer of the control beneficial interests acquired in a control beneficial interest acquisition, in good faith and not for the purpose of circumventing this subchapter as determined by the trustees, the holders of such beneficial interests shall have voting rights under this chapter and the governing instrument of the statutory trust with respect to the beneficial interests acquired, unless the acquisition of such beneficial interests by such holder constituted a control beneficial interest acquisition.").