

**MEMO# 35319**

May 17, 2023

# Maryland Amendments Apply Control Share Statute to Certain Statutory Trusts

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TO: ICI Members

Investment Company Directors SUBJECTS: Closed-End Funds RE: Maryland Amendments Apply Control Share Statute to Certain Statutory Trusts

Last week, the State of Maryland enacted several amendments to its corporate laws that, among other things, will apply its "control share" statute to registered closed-end funds and business development companies (together, "funds") that are structured as statutory trusts.<sup>[1]</sup> Importantly, Maryland's control share statute will apply automatically to any fund that is a statutory trust created on or after October 1, 2023.

A control share statute is a state law that 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 statutes and similar provisions, then briefly summarizes the amendments.

## Background

Control share statutes function as anti-takeover devices. Since the SEC staff withdrew guidance prohibiting closed-end funds from using such devices in 2020,<sup>[2]</sup> many closed-end funds have opted into state control share statutes<sup>[3]</sup> or have adopted control share provisions that provide the same effect as control share statutes in their own governing documents. Over the last few years, 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.<sup>[4]</sup> 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."<sup>[5]</sup> 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.<sup>[6]</sup>

## Summary of the Amendments

The amendments create a new section of the Maryland Statutory Trust Act that will automatically apply the Maryland control share statute to a Maryland statutory trust that is (i) a closed-end investment company as defined under the Investment Company Act; and (ii) formed on or after October 1, 2023.<sup>[7]</sup> The section also will permit a governing instrument to apply the Maryland control share statute to a Maryland statutory trust that is (i) a closed-end investment company as defined under the Investment Company Act; and (ii) formed before October 1, 2023.<sup>[8]</sup>

The amendments may address the concerns under Section 18(i) of the Investment Company Act by applying Maryland's control share statute automatically to all funds that are statutory trusts created on or after October 1, 2023, rather than allowing those funds to opt into it. Subjecting all funds to the amendments without option could enable the funds to rely on the "unless otherwise required by law" exception to the Section 18(i) requirements.

The amendments also give funds that are statutory trusts created before October 1, 2023, the option to opt into Maryland's control share statute—an option that was previously only available to Maryland corporations.

The amendments become effective on October 1, 2023.

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## Notes

<sup>[1]</sup> See Maryland House Bill 209 (Chapter 560 of the Laws of Maryland 2023) (Signed by Governor Moore on May 8, 2023), available at [https://mgaleg.maryland.gov/2023RS/Chapters\\_noln/CH\\_560\\_hb0209t.pdf](https://mgaleg.maryland.gov/2023RS/Chapters_noln/CH_560_hb0209t.pdf). Maryland's control share statute is located in Sections 3-701 to 3-710 of the Annotated Code of Maryland, Corporations and Associations.

<sup>[2]</sup> 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>.

<sup>[3]</sup> Approximately half of the states (e.g., Maryland and Delaware) have adopted state control share statutes to protect all shareholders from coercion in proposed tender offers and changes in control.

<sup>[4]</sup> 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) ("Eaton Vance case").

[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 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>. Similarly, the court in the Eaton Vance case, basing its opinion largely on the District Court decision in the Nuveen case, held that the subject fund's control share provision violated Section 18(i) of the Investment Company Act.

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] See Md. Code Ann., Corp. & Assn. § 12-307 (effective Oct. 1, 2023). Funds are "closed-end investment companies" under the Investment Company Act. See Sections 4 and 5(a)(2) of the Investment Company Act.

[8] See Md. Code Ann., Corp & Assn. § 12-307(B) (effective Oct. 1, 2023).