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Alert

Regulated Funds and Activism: SEC Staff Issues No-Action Position on Permissibility of Reliance on State Control Share Acquisition Statutes by Closed-End Funds

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On May 27, 2020, the staff of the Division of Investment Management of the SEC ("Staff") withdrew previously issued Staff guidance addressing the relationship between state control share acquisition statutes ("control share statutes") and the voting requirements of Section 18(i) of the Investment Company Act of 1940, as amended ("1940 Act"), and adopted a new no-action position in its place ("No-Action Position").[1] Control share statutes have been adopted by approximately half the states in the United States as a defensive measure to protect corporations and their existing shareholders from hostile or speculative takeovers. However, these control share statutes had previously been viewed by the Staff as being inconsistent with Section 18(i), which requires that every share of stock issued by a registered management company must be a "voting stock" and have "equal voting rights" as every other share of outstanding stock.[2]

The No-Action Position replaces the Staff's prior position expressed in its letter to Boulder Total Return Fund Inc. ("Boulder Letter"),[3] which discussed the interplay between Section 18(i) and the Maryland Control Share Acquisition Act ("MCSAA"). In the Boulder Letter, the Staff stated that by opting into the MCSAA, which limits the voting rights of control shares except to the extent approved by a Maryland corporation's shareholders, a closed-end fund would be operating in a manner "inconsistent with the wording of, and purposes underlying, Section 18(i)."[4] Notably, the Staff had articulated its position on an informal basis for several years prior to issuance of the Boulder Letter, which followed court decisions that ran contrary to the Staff's then-current view on the topic.

In September 2018, SEC chairman Jay Clayton directed the Staff to review prior Staff statements and documents to determine whether more recent market or other developments provided a basis to modify, rescind or supplement them. As a result, the Staff determined to rescind the Boulder Letter and to take the position that, under certain circumstances, a closed-end fund may opt into a state control share statute without risking an enforcement action against the fund under Section 18(i). The Staff Position requires that the decision to opt-in to or otherwise trigger a control share statute must be the decision of the board of directors of the fund, taken with "reasonable care on a basis consistent with

[1] "Control Share Acquisition Statutes," *SEC Staff Statement*, May 27, 2020, available here.

[2] 15 U.S. Code § 80a–18.

[3] "Boulder Total Return Fund, Inc.," *SEC No-Action Letter*, November 15, 2010, available here.

[4] *Id*.

other applicable duties and laws and the duty to the fund and its shareholders generally."[5] The Staff further notes that fund boards determining whether to opt in to a control share statute must consider "(1) the board's fiduciary obligations to the fund, (2) applicable federal and state law provisions, and (3) the particular facts and circumstances surrounding the board's action."[6] While these factors must be considered by the board of a fund deciding whether to opt in to a control share statute, the No-Action Position now provides a potential path for closed-end funds to opt in to such statutes that was previously blocked under the Boulder Letter.

The adoption of the Staff's No-Action Position could have a chilling effect on activism within the closed-end fund space, particularly in view of the many challenges insurgents already face under the 1940 Act. For example, for the many closed-end funds incorporated in Maryland, a simple board resolution would likely permit a fund to opt into the MCSAA, and thereby block an investor from obtaining a meaningful stake of a fund's outstanding shares. Notably, however, the Staff statement also requests feedback on several questions relating to the impact of control share statutes and other related matters, in order to determine whether additional SEC action involving this matter is warranted. Given this opening, we would expect larger investors, activists and other stakeholders within the closed-end fund space to express their views on both the No-Action Position, as well as the interplay between other anti-takeover measures and the 1940 Act, to help shape the Staff's views going forward.

If you have any questions about the content of this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[5] "Control Share Acquisition Statutes," *SEC Staff Statement*, May 27, 2020, available here.

[6] *Id*.