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Second Circuit Affirms Lower Court Decision Regarding Closed-End Fund Control Share Bylaw Provision

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The U.S. Court of Appeals for the Second Circuit upheld a ruling of the U.S. District Court for the Southern District of New York that invalidates control share bylaw provisions adopted by certain closed-end funds organized as Massachusetts business trusts.

On January 14, 2021, Saba Capital Management, L.P. and a private fund managed by Saba brought an action against a group of Nuveen-sponsored closed-end funds organized as Massachusetts business trusts and their trustees seeking rescission of a control share bylaw provision and a declaratory judgment to the effect that the provision is unlawful[1]. The control share bylaw provision in question generally provides that an acquisition of shares that results in a shareholder owning more than 10 percent of a fund's outstanding shares prevents that shareholder from voting shares in excess of 10 percent unless specifically authorized by the affirmative vote of the fund's other shareholders. The control share bylaw provision is intended to operate in a manner similar to control share provisions under state corporate statutes.

Nuveen argued that Saba did not have standing because Saba had intended only to purchase additional shares in the Nuveen-sponsored closed-end funds, but had not yet done so. Nuveen further argued that its funds' bylaws were intended to reduce the likelihood of a fund succumbing to "undue influence by opportunistic traders pursuing short-term agendas adverse to the best interests of the [f]und and its long term shareholders."

The plaintiffs contended that the control share bylaw provision was inconsistent with Section 18(i) of the 1940 Act, which provides that "every share of stock . . . issued by a registered management company . . . shall be a voting stock and have equal voting rights with every other outstanding voting stock . . . ." The defendants presented numerous arguments against the plaintiffs' contention, and in particular noted the SEC staff's recission in May 2020[2] of a 2010 no-action letter (the Boulder letter[3]) setting forth the staff's view that a closed-end fund opting into a state control share statute would be inconsistent with Section 18(i). The Investment Company Institute submitted an amicus curae brief supporting the use of control share bylaws by closed-end funds.

On February 17, 2022, the U.S. District Court for the Southern District of New York granted a motion for summary judgment in favor of the plaintiffs on their claims for rescission of the control share bylaw provision[4] and a declaratory judgment concluding that the provision was inconsistent with Section 18(i) of the 1940 Act. In so deciding, the court focused on the plain language of Section 18(i), concluding that what makes a stock "voting" depends on its holder's ability to "presently vote the stock," and that a control share bylaw provision that deprives a shareholder of this ability, even temporarily,

[1] See Saba Capital CEF Opportunities 1, Ltd., et al. v. Nuveen Floating Rate Income Fund, et al., No. 21-cv-327 (S.D.N.Y. Feb. 17, 2022).
[2] See Control Share Acquisition Statutes, Staff Statement, Division of Investment Management (May 27, 2020), available at https://www.sec.gov/investment/control-share-acquisition-statutes.
[3] Boulder Total Return Fund, SEC No-Action Letter (Nov. 15, 2010), available at https://www.sec.gov/divisions/investment/noaction/2010/bouldertotalreturn111510.htm.
[4] See Saba Capital CEF Opportunities 1, Ltd., et al. v. Nuveen Floating Rate Income Fund, et al., No. 22-cv-407 (2d. Cir. Nov. 30, 2023).

renders the stock not a "voting security" under the 1940 Act. The defendants appealed the district court's granting of the motion for summary judgment.

On November 30, 2023, the U.S. Court of Appeals for the Second Circuit affirmed the district court's decision to grant the plaintiffs' motion for summary judgment to rescind the defendant's funds' control share bylaw provision. The appellate court held that the control share bylaw provision violated Section 18(i) of the 1940 Act, stating that the language of the statute is "plain and unambiguous" and that the provision violated Section 18(i) "because it deprives some shares of voting power but not others—contrary to the [statutory] provision's guarantee of 'equal voting rights.'" (Emphasis in original.) On appeal, the defendants argued that the bylaw provision did not violate Section 18(i) because the provision's restriction of voting rights applied only to certain shareholders, not to shares, and that Section 18(i) relates only to restrictions on shares. The appellate court rejected this distinction as being unsupported by court interpretations of federal law applicable to voting rights. Additionally, the appellate court rejected the defendants' policy-based argument that the 1940 Act should be interpreted so as to protect funds against activist investors, stating that the court decided not to deviate from the 1940 Act's plain meaning.

We will continue to monitor this and other litigation pertaining to the ability of closed-end funds to use control share bylaw provisions or state control share statutes as a means to defend against activist investor campaigns and will provide updates when additional actionable guidance becomes available.

If you have any questions, please contact **Jacob C. Tiedt** at jtiedt@vedderprice.com, **Deborah B. Eades** at deades@vedderprice.com or any other Vedder Price attorney with whom you have worked.