

CLIENT ALERT

Delaware Enacts Control Share Acquisition Statute for Listed Closed-End Funds and BDCs Organized as Statutory Trusts

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The Delaware Statutory Trust Act was amended, effective August 1, 2022, to include control share acquisition provisions (the “Delaware CBIA Statute”).¹ The Delaware CBIA Statute automatically applies to Delaware statutory trusts that are registered as closed-end management investment companies under the Investment Company Act of 1940, as amended (the “1940 Act”), or regulated as business development companies (“BDCs”) under the 1940 Act, and have a class of equity securities listed on a national securities exchange or designated for trading on NASDAQ. Control share acquisition statutes generally provide companies, including closed-end funds and BDCs, with the ability to limit the influence of large shareholders by limiting voting rights when a person acquires ownership of shares that are equal to or greater than certain specified percentages of the company’s total voting power. Approximately half of the U.S. states have a form of corporate control share acquisition statute.²

¹ Delaware Statutory Trust Act, 12 Del. C. § 3881-§ 3887. The Delaware Statutory Trust Act generally uses the term “beneficial interest” when referring to interests of the statutory trust in contrast with corporate statutes which refer to “shares” of the corporation.

² Arizona, Florida, Hawaii, Idaho, Indiana, Kansas, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Nebraska, Nevada, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Utah, Virginia, Wisconsin and Wyoming all have control share acquisition statutes in effect. See *generally* Control Share Acquisition Statutes, SEC Staff Statement (May 27, 2020) (the “Staff Statement”), available [here](#).

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Overview of the Delaware CBIA Statute

Under the Delaware CBIA Statute, a person who makes or proposes to make a “control beneficial interest acquisition” (an “acquiring person”) will have no voting rights with respect to “control beneficial interests” of the statutory trust acquired in such an acquisition. A “control beneficial interest acquisition” is “the acquisition, directly or indirectly, by any person of ownership of, or the power to direct the exercise of voting power with respect to, issued and outstanding control beneficial interests.”³ The Delaware CBIA Statute generally defines “control beneficial interests” to include beneficial interests that, in the absence of the Delaware CBIA Statute, if aggregated with all other beneficial interests of the statutory trust (including beneficial interests acquired in an acquisition that is excluded from the definition of “control beneficial interest acquisition”) owned by the acquiring person and its “associates”⁴ or in respect of which the acquiring person and its associates are entitled to exercise or direct the exercise of voting power, would entitle that person, directly or indirectly, to exercise or direct the exercise of voting power of beneficial interests of the statutory trust in the election of trustees within any of the following ranges of voting power:

- 10% or more, but less than 15% of all voting power;
- 15% or more, but less than 20% of all voting power;
- 20% or more, but less than 25% of all voting power;
- 25% or more, but less than 30% of all voting power;

³ Delaware Statutory Trust Act, 12 Del. C. § 3881(d)(1). Excluded from the definition of “control beneficial interest acquisition” are acquisitions of beneficial interests: (1) before August 1, 2022; (2) under a contract entered into before August 1, 2022 creating a binding obligation to purchase beneficial interests at a set price; (3) under the laws of descent and distribution; (4) under the satisfaction of a pledge or other security interest created in good faith and not for the purpose of circumventing the Delaware CBIA Statute as determined by the statutory trust’s trustees; and (5) under a merger or consolidation effected under § 3815 of the Delaware Statutory Trust Act if the statutory trust is the surviving or resulting party in the merger or consolidation, except with respect to any shares issued to a holder of control beneficial interests in the target party. Delaware Statutory Trust Act, 12 Del. C. § 3881(d)(2).

⁴ The definition of “associate” is broad and encompasses a number of parties related to an acquiring person. “Associate”, when used to indicate a relationship with any person, means: (1) Any other person (other than the statutory trust or a subsidiary of the statutory trust) of which such person is an officer, director, or partner or is, directly or indirectly, the holder of 10 percent or more of any class of equity securities; (2) Any trust, corporation or other entity in which such person has a substantial beneficial interest or as to which such person serves as a director, trustee or in a similar fiduciary capacity; (3) Any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a trustee or officer of the statutory trust or any of its affiliates; or (4) Any other person that: a. Directly or indirectly controls, or is controlled by, or is under common control with, the person specified, which will include any investment fund or other collective investment vehicle that has the same investment adviser as the person specified; b. Is acting as an investment adviser with regard to any person specified that is an investment fund or other collective investment vehicle; or c. Is acting or intends to act jointly or in concert with the person specified.” Delaware Statutory Trust Act, 12 Del. C. § 3881(c).

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- 30% or more, but less than a majority of all voting power; or
- A majority or more of all voting power.⁵

A member of a national securities exchange is not deemed to be a holder of control beneficial interests solely because such member is the record holder of the beneficial interests. Control beneficial interests are not counted as outstanding in determining whether a quorum has been obtained or any other matters related to voting, including whether any required vote has been obtained.

The Delaware CBIA Statute, unlike the control share acquisition statutes of certain other states, is an “opt-out” statute, meaning that it automatically applies without action by the trustees of the statutory trust. The Delaware CBIA Statute does, however, allow a statutory trust’s governing instrument or board of trustees to provide exemptions from the statute’s limitations to acquisitions of beneficial interests “specifically, generally, or generally by types, as to specifically identified or unidentified existing or future beneficial owners or their affiliates or associates, or as to any series or classes of beneficial interests.”

An acquiring person may obtain voting rights with respect to its control beneficial interests with the approval of two-thirds of the statutory trust’s shareholders, excluding all “interested beneficial interests,”⁶ at a shareholder meeting. The Delaware CBIA statute sets out procedural requirements for the shareholder meeting, including requirements for the acquiring person to deliver an “acquiring person statement” to the statutory trust and undertake to pay the expenses of holding a special shareholder meeting.

A control beneficial interest acquisition is triggered at each of the voting ranges set out above. This means that if shareholders approve voting rights for an acquiring person’s control beneficial interests at a particular range and the acquiring person later acquires control beneficial interests at a higher range, the acquiring person will be required to seek shareholder approval to obtain voting rights for the control beneficial interests at the higher range.

Acquiring persons are required to disclose to the statutory trust any control beneficial interest acquisition within 10 days of the acquisition. Upon request from the statutory trust, acquiring persons must provide, within 10 days of the request, any

⁵ If the statutory trust subsequently issues additional beneficial interests, all control beneficial interests prior to such issuance will remain control beneficial interests, even if they represent a percentage of voting power that is below the ranges set out above. Delaware Statutory Trust Act, 12 Del. C. § 3881(e)(2).

⁶ “Interested beneficial interests” are defined as “beneficial interests of a statutory trust in respect of which any of the following persons is entitled to exercise or direct the exercise of the voting power of beneficial interests of the statutory trust in the election of trustees: (1) An acquiring person; (2) An officer of the statutory trust; (3) An employee of the statutory trust who is also a trustee of the statutory trust; or (4) A trustee of the statutory trust who is an ‘interested person’ of the statutory trust as defined in the 1940 Act or any rule adopted thereunder.” Delaware Statutory Trust Act, 12 Del. C. § 3881(f).

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information that the trustees of the statutory trust reasonably believe is necessary or desirable in making a determination as to whether a control beneficial interest acquisition has occurred.

The SEC and Control Share Acquisition Statutes

The enactment of the Delaware CBIA Statute follows the issuance of the Staff Statement in May 2020, in which the staff of the Securities and Exchange Commission (“SEC”) withdrew a 2010 letter to Boulder Total Return Fund (the “Boulder Letter”) in which it had addressed the relationship between the voting requirements of Section 18(i) of the 1940 Act and the Maryland Control Share Acquisition Act (the “MCSAA”).⁷ The Boulder Letter concluded that opting in to the MCSAA was inconsistent with Section 18(i) of the 1940 Act, which generally requires every share of stock to have “equal voting rights” with every other outstanding voting stock. The Staff Statement replaced the Boulder Letter with a no-action position that the SEC staff would not recommend enforcement action against a closed-end fund under Section 18(i) of the 1940 Act for “opting in to and triggering a control share statute if the decision to do so by the board of the fund was taken with reasonable care on a basis consistent with other applicable duties and laws and the duty to the fund and its shareholders generally.”⁸

Implications of the Statute

Control share acquisition statutes, such as the Delaware CBIA Statute, offer potential defensive measures against activist investors. Listed closed-end funds and BDCs organized as Delaware statutory trusts need not take any affirmative action to be subject to the provisions of the Delaware CBIA Statute. Boards of trustees should work with counsel to consider the implications of the statute and whether any (or all) acquisitions of beneficial interests should be exempted from application of the Delaware CBIA Statute.

⁷ Boulder Total Return Fund, SEC No-Action Letter (Nov. 15, 2010), available [here](#); see also Staff Statement, *supra* note 2.

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