Nuveen Fights Ruling Against Control-Share Bylaw

A federal district judge sided last month with Saba Capital in its case against the fund company's closed-end fund provision that prevents shareholders from voting their shares over 10% without approval from other investors.

By Whitney Curry Wimbish | March 8, 2022

Nuveen fund directors are appealing a recent court ruling that prompted them to reverse a bylaw change affecting how large shareholders in certain closed-end funds can vote their shares.

"The Board adopted a control share by-law to protect the interests of the funds and their shareholders against predatory attacks by hedge funds, and we look forward to exercising our rights on appeal," Nuveen independent fund board chair **Terence Toth** said in an email via a spokesperson. "In taking this action, we continue to act in the best interests of shareholders by vigorously protecting their ability to access income-producing strategies against hedge funds seeking short-term profits to the detriment of our shareholders."

The case involves five Nuveen closed-end funds and 10 directors.

U.S. District Judge J. Paul Oetken of the Southern District of New York sided late last month with **Saba Capital** in its 2021 case alleging that certain Nuveen closed-end funds and their independent directors violated the '40 Act when they amended bylaws preventing big shareholders from voting their shares over 10% without approval from other investors.

"Section 18(i)'s requirements that every stock be voting and have equal voting rights are clear and unambiguous," Oetken wrote. "Whether Saba's investment strategies were detrimental to the trusts does not change the fact that, under the control share amendment, control shareholders' newly acquired stock does not always presently entitle them to vote and that there are unequal voting rights among stock."

The ruling came after the Securities and Exchange Commission's 2020 decision to remove barriers to funds' use of state laws that allow closed-end funds to limit big investors from voting their shares over a certain percentage without the approval of other investors.

Twelve years ago, the SEC's position aligned with Oetken's ruling and held that control share acquisition laws were inconsistent in Section 18(i) of the '40 Act. But two years ago, the regulator reversed its position, saying it wouldn't recommend enforcement action against funds that used those laws. **BlackRock**, **Legg Mason**, and at least 10 others, subsequently moved to opt in to them.

Others, like Nuveen, amended their bylaws to institute similar limits, including **First Trust**, **Putnam** and **Franklin Templeton**. Based on regulatory filings, those provisions appear to remain in place.

The judge's opinion said that the new article defined a "control share acquisition" as a shareholder's acquisition of shares that, when combined with shares already owned, would lead to the shareholder owning 10% of the trust's total shares. A shareholder in that position would be barred from voting the stock in excess of 10% acquired unless authorized by an "affirmative vote of the holders of a majority of all the shares entitled to vote" excluding any shares owned by a control shareholder.

Saba's complaint sought a rescission of the bylaws and a declaratory judgment that the control share amendment is illegal.

Oetken agreed, writing that, under the amendment, "stock do not have equal voting rights: the voting rights of stock owned by control shareholders are inferior to the voting rights of stock owned by non-control shareholders." He continued, saying that, if the conditions within the control share amendment aren't met, "a control shareholder's stock can completely lose its voting rights." The same isn't so for non-control shareholders' stock.

"This asymmetry in voting rights runs afoul of Section 18(i)'s requirement of equal voting rights," he wrote.

Because Saba owns at least 9.9% of the outstanding shares in each of the trusts, its acquisition of any more stock would turn its stock into a control share subject to the illegal amendment, the judge wrote in his opinion.

"Saba has already suffered the injury of being unable to acquire additional shares that are voting stock with equal voting rights with every other outstanding stock," Oetken wrote. "And the law does not require that Saba experience the further injury of actually purchasing stock with unequal voting rights to request declaratory relief."

In response to the ruling, Saba said in a statement that it was a significant victory for closed-end fund shareholders, who are primarily retail investors, "and should have far-reaching implications for other closed-end funds that have attempted to entrench trustees and investment advisors."

"The ability for shareholders to vote all of their shares is one of the most essential elements of the Investment Company Act," said Saba partner and general counsel **Michael D'Angelo**. "Without it, shareholders lack the ability to hold management teams and trustees accountable for excessive fees, poor performance and governance failures."

Saba did not comment by deadline about Nuveen's appeal.

Hedge fund activist **Phil Goldstein**, who heads **Bulldog Investors**, was likewise laudatory, saying he thought the ruling was "good for shareholders and bad for entrenched management." Other fund companies may wait until the appeal is decided before making changes to their own bylaws or decisions to opt in to state laws, he said. But activists are unlikely to wait themselves and will take the initial ruling as a cue to file their own lawsuits, he added.

"All the funds out there that have these bylaws or opted in to the statute are vulnerable now to the same lawsuit. Even while this appeal's going on, they may wind up in litigation," he said. "If I look at a fund that we want to be active in, and they have opted in, one of the things I would do is consider suing them just to get rid of the bylaw."

John Cole Scott, founder and executive chair of **Active Investment Company Alliance**, said he was not surprised by the ruling and did not think the appeal would be successful. He also said removing any control share mechanisms would generally be better for investors.

"This should be better for long-term trading in the U.S. closed-end market," Scott said.

Industry members were more skeptical. **Independent Directors Council** managing director **Thomas Kim** said the organization was disappointed with the decision. "Other courts correctly decided that independent directors of closed-end funds can protect the funds from activist demands by using takeover defenses that differentiate among shareholders. Having effective tools is critical to protecting funds' interests," he said through a spokesperson.

Last year, a Massachusetts state court judge issued a ruling in a legal battle between Saba and **Eaton Vance** involving control shares that was similar to Oetken's, as reported.

The initial Nuveen decision was not the blockbuster some have made it out to be, because not all fund companies rushed to implement control-share permissions, industry players said. For one thing, proxy advisory firm **ISS** said it would recommend against any board that adopted such provisions without shareholder approval, said **Paul Torre**, president of the governance, proxy and ownership services division at **AST Fund Solutions**.

"That's why a lot of funds didn't just run out and do it," he said, meaning that the initial ruling will likely increase activist activity but not by a drastic amount. Boards overseeing funds with a control share mechanism should ask for information about the risk of keeping it in light of the ruling and, if they remove it, what happens if Nuveen wins its appeal.

"The things I'm thinking about and watching are seeing how these appeals go," he said, "and what if any action the regulators take and what the ICI is going to do."