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VIA FEDERAL EXPRESS

Mr. Paul Cellupica
Deputy Director and Chief Counsel
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request for Guidance by Special Opportunities Fund, Inc.

Dear Mr. Cellupica:

This firm represents numerous investors in closed-end funds ("CEF"). Our clients also include registered investment advisers, who may hold shares of CEFs for their customers, as well as private funds that invest primarily in CEFs. We therefore have a strong interest in assuring the fair treatment of CEF shareholders in accordance with their rights under the Investment Company Act of 1940 (the "ICA").

We are submitting this letter to register our strenuous objection to the proposed by-laws discussed in the Request for Guidance by Special Opportunities Fund, Inc. ("SPE"), which was submitted to the Staff on December 2, 2019, and attached to a Form 8-K filed by SPE on December 3, 2019. The proposed by-laws sound the death knell for the shareholder franchise in CEFs, an outcome that would both frustrate the ICA and harm the financial performance of these funds, separating control from their true owners (shareholders) and passing it to the directors.

SPE seeks interpretive guidance were its board to enact by-law provisions that (a) require a majority, rather than a plurality, to elect directors in contested elections; (b) impose a 4.99% share ownership limitation; and (c) designate certain serving directors as "continuing directors". Any of the three by-law amendments proposed by SPE would nullify the shareholder franchise and undermine the clear legislative goals underpinning the ICA. Board and management company support of such provisions is contrary to the duties owed by fiduciaries to CEF shareholders and should not be supported through no-action relief.

To protect investors in CEFs, we urge the Staff to respond swiftly to the SPE request, advising that each proposed bylaw has no place under the ICA.

The Importance of Shareholder Vote to CEF Shareholders

When Congress enacted the ICA in 1940, it engaged in extensive fact-finding and identified certain abuses, including the operation of investment companies "in the interest of

directors, officers, investment advisers . . . rather than in the interest of all classes of such companies' securities holders" and the issuance of "securities containing inequitable or discriminatory provisions." ICA §§ 1(b)(2) and (3), 15 U.S.C. §§ 80a-1(b)(2) and (3). A particular concern included arrangements by which management maintained control of a fund, effectively leaving control with a small group of shareholders. *See* Securities and Exchange Commission, *Report on Investment Trusts and Investment Companies*, pt. 3, ch.4, H.R. Doc. No. 136, 1620-1641, 77th Cong., 1st Sess. (1940) (the "Trust Report").

For these reasons, Congress "focused on the protection of the rights of investment company shareholders and imposed on investment companies a unique corporate governance system that seeks to reduce the conflicts of interest that are inherent in the investment company form," and, in particular, imposed a "governance system [that] relies heavily on shareholders' ability to exercise voting rights that serve as a check on investment company insiders." *Boulder Total Return Fund Inc.*, SEC No-Action Letter, 2010 WL 4630835, at *6 (Nov. 15, 2010) (*Boulder No-Action Letter"*) (citations omitted). The ICA therefore requires *annual* shareholder approval of the investment company's board of directors. ICA § 16(a), 15 U.S.C. § 80a-16(a); *see also* ICA § 15(a), 15 U.S.C. §§ 80a-15(a) (requiring approval of management contract); ICA §§ 13(a)(1)-(4), 15 U.S.C. §§ 80a-13(a)(1)-(4) (requiring shareholder approval of certain fundamental investment policies); ICA § 18(i), 15 U.S.C. § 80a-18(i) (ensuring that each investment company stockholder has a vote proportionate to his or her stockholdings).

From time to time, investment companies have sought to encroach upon the shareholder franchise, seeking either exemptive or no-action relief. These requests show that the abuses that Congress sought to address in 1940 remain of concern. Thus, in 1966, in response to an effort to exempt variable annuities from ICA's requirements, the Commission denied the requested relief, writing:

> Prudential's proposals clearly contemplate, in effect, a total exemption from all of the sections of the Act which together express and effectuate the policy that those at risk in investment funds should have ultimate voice in their management and policy. As we have indicated throughout this opinion, that policy and those sections are in large part the very essence of the Act. To grant exemptions here would be in effect the equivalent of a total exemption and contradictory to our principal holding.
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> Specifically the Act requires that those having funds at risk in the equity securities of an investment fund elect its directors. The directors or the holders must recurrently review the principal underwriting and investment advisory arrangements and have the power to change or terminate them. Holders must pass on changes in investment policy and ratify the selection by the directors of the independent auditors of the fund. The percentage of directors of the fund who may be affiliated with the investment adviser is subject to strict limits. The effect of these sections is not only to place the power of control in the holders, but to prevent its usurpation by any others, management or outside party, through long-term contract or otherwise. The purpose is not only to secure honesty and objective

> 'wisdom' in management, but to make it separately responsive to the wishes and judgment of those who depend upon its results.

In re Prudential Ins. Co. of America, 41 S.E.C. 335, 350 (1963), *aff'd sub nom. Prudential Ins. Co. of America v. S.E.C.*, 326 F.2d 383 (3rd Cir. 1964), *cert. denied*, 377 U.S. 953 (1964) (citations and footnotes omitted).

The Trust Report observed that CEFs pose particular concerns, because "the shareholder does not have the right to compel redemption of his shares at asset value, the investor must dispose of his securities in the open market, and when performance is indifferent these securities may be selling at substantial discounts from their asset values." *Id.* at 1874.

These concerns not only remain alive today, but have been amplified by the wide-spread adoption by states of anti-takeover statutes. Although closed-end funds and management may point to the supposed deleterious (and perhaps imaginary) effects of arbitrageurs attempting to earn profits where funds trade at a discount to net asset value, a 2015 study of the financial impact of takeover defenses at 622 funds suggests that the takeover defenses themselves are an indicator of long-term negative effect on market value. *See* Matthew E. Souther, *The effects of takeover defenses: Evidence from closed-end funds*, Journal of Financial Economics 119(2) at 420-440 (2016). In particular, Souther found that takeover defenses correlate to higher management fees and compensation levels for directors, leading to the conclusion that "the board of directors, in the unique position of setting their own compensation contracts while having power over defense adoptions, are shown to reap significant financial benefits from the use of defenses." *Id.*

For these reasons, consistent with past Commission and Staff guidance, takeover defenses proposed for CEFs deserve particular scrutiny. Asked to consider whether a by-law opting to adopt such a provision, the Maryland Control Share Acquisition Act ("MCSAA"), would be consistent with the ICA § 18(b), the Staff wrote:

> Any interpretation of Section 18(i) that envisages personal discrimination against an investment company shareholder would be flatly inconsistent with the purposes of Sections 18(i) and 1(b) and the special protection that Congress mandated for investment company shareholders.... Although discrimination between and among shareholders may be permitted for operating companies that use the MCSAA, such discrimination is not permitted for a CEF.

Boulder No-Action Letter, at *11. SPE's proposals require similar scrutiny for discriminatory purpose. We review each proposal below.

The Majority Voting Provision

The majority voting by-law proposed by SPE seeks to side-step the ICA through a seemingly neutral provision that would, effectively, make it impossible to elect directors

nominated by CEF shareholders in a contested election. There can be no conceivable purpose for such by-laws except to insulate incumbent boards from contested elections, and deter shareholders from even seeking to mount a challenge.

Historically, most CEF by-laws provided that directors may be elected by a plurality. Under a plurality, the winning candidate must get more votes than a competing candidate. This is akin to a political election: only people who show up to vote have their votes counted, and the candidate who receives the most votes wins. This outcome comports with well-established concepts of a fair election.

When a by-law requires majority vote, however, the challenger must be elected by majority of shares outstanding. This tilts the playing field to incumbent directors, who hold over and retain their seats if the challenger falls short of this very high bar. Indeed, the shareholder nominee cannot achieve the 50% threshold without extraordinary – and unprecedented -- high voter turnout, a practical impossibility. A non-vote effectively counts as a vote for the incumbent slate. We have observed that these provisions take two forms: a majority requirement for all director elections,[1] and a majority requirement, imposed only for contested director elections.[2]

These by-laws are the exact opposite of those recommended by the Council of Institutional Investors and other corporate governance advocates. *See FAQ: Majority Voting for Directors*, Counsel for Institutional Investors (Jan. 2017) (https: //www. cii.org/files/issues_and_advocacy/board_accountability/majority_voting_directors/CII%20Majority%20Voting%20FAQ%201-4-17.pdf); Model Business Corporation Act (2016 Revision), American Bar Assoc. § 10.22(a)(2) (Dec. 9, 2017) ("to be elected, a nominee shall have received a plurality of the votes cast by holders of shares entitled to vote in the election at a meeting at which a quorum is present"). There is no conceivable rationale to require a majority vote in a contested election other than to protect incumbents. Unfortunately, the market forces that encourage good corporate governance at S&P 500 companies are absent from CEFs.

The switch to a majority voting requirement in the context of a contested election at a CEF will, in almost every instance, prevent the election of shareholder nominees, given the dynamics of CEF voter turnout. Reference to recent contested elections is illustrative. In an election involving NHS, the quorum at the 2019 annual meeting, consisted of approximately 59% of shares

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[1] For example, in 2010, the Neuberger Berman High Yield Strategies Fund Inc. (NHS) amended its by-laws to state: "Except as otherwise provided in the Articles of Incorporation or these Bylaws or as required by provisions of the 1940 Act, all matters shall be decided by a vote of the majority of the votes validly cast. *A director shall be elected by a majority of the outstanding shares of the Fund entitled to vote thereon*" (emphasis added). In October 2019 alone, at least twenty other CEFs advised by Legg Mason Partners Fund Advisors, LLC adopted this provision.

[2] For example, in 2016, the Blackrock Credit Allocation Income Trust (BTZ) amended its by-laws to state that "(i) with respect to the election of directors, other than a Contested Election, the affirmative vote of a plurality of the Shares represented in person or by proxy at any meeting at which a quorum is present shall be the act of the shareholders with respect to such matter, (ii) *with respect to a Contested Election, the affirmative vote of a majority of the Shares outstanding and entitled to vote with respect to such matter at such meeting shall be the act of the shareholders with respect to such matter*, (iii) for all other items of business, the affirmative vote of a majority of the Shares represented in person or by proxy at any meeting at which a quorum is present and entitled to vote" (emphasis added).

eligible to vote. Although approximately two thirds of the votes cast favored the dissident slate, that number fell short of the majority requirement. By all traditional notions of fairness, the challenger won – by a landslide. Under the majority vote by-law, he lost. In other 2019 elections at which shareholders had nominated alternative slates or made proposals to declassify the board of which we are aware, turnout ranged from 54-66%.[3] These numbers are not surprising given widespread holdings by small retail investors. The majority voting requirement would effectively require a super-majority of voters in favor of a nominee, from 70% to 90% or higher, depending on actual turn-out. This makes it a virtual certainty that no director nominated by shareholders will be elected and that the incumbent directors, even those who receive as little as 10% of the vote, will remain in office.

We note that the ICA does not explicitly prohibit a majority voting provision. This is likely because Congress had no contemplation that fund directors would deviate from well-established standards for corporate elections by adopting tactics like the majority voting provision. The above examples of the practical effect of a majority voting provision demonstrate that such provisions are inconsistent with the ICA's goals, as stated at ICA §§1(b) and 16(a). Moreover, it is noteworthy that the ICA is explicit regarding another common means of reducing shareholder power to effect board change, the classified board. Thus, while Section 16(a) provides that the ICA does not "preclude a registered investment company from dividing its directors into classes," it imposes the following requirements: "That no class shall be elected for a shorter period than one year or for a longer period than five years and the term of office of at least one class shall expire each year." In other words, while classified boards are permitted, the ICA sets strict parameters to deter abuse. Under Congress' regulatory regime, it would be misplaced to endorse the use of majority voting provision, which will further abuse, and de facto permit a director to serve only at the pleasure of his fellow directors who have the power to nominate him or her.

Another practical effect of the majority provision is that, in a contested election, the open board seat will not be filled, because no nominee receives a vote of a majority of all shareholders entitled to vote in the election. The default under state law is that the incumbent retains his seat until a successor is qualified. The incumbent director will continue to serve, not at the pleasure of the shareholders, but subject to the dictates of the other directors, who may or may not re-nominate him at the next annual meeting. This is in contravention of the ICA which requires the annual election of directors.

We anticipate that those supporting the proposed by-law will rely upon *Badlands Trust Co. v. First Financial Fund, Inc.*, 65 Fed. Appx. 876 (4th Cir. 2003). In the election at issue in that case, roughly 35% of shareholders voted for the management slate and 60% supported the slate nominated by Badlands. *Id.* at 877. But the challenger, Badlands, lost the election. The fund had a majority voting by-law and the dissident slate received votes from only 47% of the outstanding shares eligible to vote. The district court granted Badlands' request for preliminary injunctive relief, finding that the majority provision violated Maryland law and required the fund to seat

[3] Additional examples of turnout at 2019 annual meetings at which shareholders voted on proposals to declassify the board and/or alternative director slates, based upon final reports of the inspector of election, are: BTZ, 66%; Nuveen Ohio Quality Municipal Fund, 63%; Blackrock Muni New York Intermediate Duration Fund, Inc., 54%; Western Asset High Income Fund II Inc., 55%.

Badlands' nominees as directors. The appellate court reversed, holding that Maryland law permitted a majority vote by-law. *Id.* at 878. Having done so, the court next held (assuming that there is a private cause of action under Section 16(a)), that Section 16(a) had not been violated by the board's appointing the defeated directors because the directive that, "No person shall serve as a director of a registered investment company unless elected by the holders of the outstanding securities of such company, at an annual or special meeting called for that purpose," required only that the director had once been elected at a meeting, even if not the meeting at issue. *Id.* at 879, citing ICA § 16(a). In other words, a director properly elected one year may satisfy the ICA by holding over for a decade or more. The appellate court, we submit, erred. Its holding subverts both the ICA and the shareholder franchise, by allowing a director who is elected one time to hold over for many more times. The purpose and structure of the ICA clearly contemplated an annual election.

The appellate court reasoned that the appointment of holdovers is a "stopgap measure [that] provides for the smooth functioning of corporate governance and gives time for shareholders to hold new elections. If holdovers are not permitted, the only recourse in failed elections would be the dissolution of the corporation." *Id.* This makes sense in the context of vacancies caused by resignation, disability or death, but not when a decisive majority of shareholders has voted against the board's nominees. Under those circumstances, such conduct raises concerns that CEF fiduciaries are not complying with their obligations under ICA § 36(a) and Section 206 of the Investment Advisers Act, 15 U.S.C. § 80(b)(6).

Lastly, it bears consideration that a CEF shareholder does not lightly nominate a dissident slate, due to the enormous costs and time commitment of mounting a campaign and the challenge, of winning the election when the Board may spend shareholder money to defend its seats. CEF shareholders take such steps when fund assets are most at risk, such as when there is an outsized discount between net asset value and share price and long-term board entrenchment. The harm to shareholders of majority by-law provisions, as well as the illicit incentive provided to incumbent boards, is readily apparent.

The Shareholder Ownership Limitation

SPE's proposal to enact a 4.99% share ownership limitation is equally troubling. Under the proposed by-law, any acquisition of shares by shareholder that owns over 4.99% of the funds' common stock would be "null and void to the fullest extent permitted by law." Such "Excess Shares" would not be entitled to, unless the board makes an exception, "the rights to vote or to receive dividends and liquidating distributions with respect to the Excess Shares."[4] By making this proposal, SPE is essentially asking the Staff to nullify its interpretation in the Boulder No-Action letter that opting into a MCSAA provision that permitted an analogous 10% share limitation would be acting in a manner inconsistent with the ICA. Boulder No-Action Letter at *1, *12.

[4] The by-law is based on that of Amended and Restatement and Declaration of Trust of the Dividend and Income Fund (DIF) as of December 13, 2018. Under DIF's by-law, the fund may seek money damages from the shareholder and the restrictions on the Excess Shares may remain in place indefinitely.

The well-founded position taken in the Boulder No-Action Letter should not be revisited. SPE's proposed shareholder ownership restriction directly violates Section 18(i) of the ICA, which states, in pertinent part, "Except as provided in subsection (a) of this section, or as otherwise required by law, every share of stock hereafter issued by a registered management company . . . shall be a voting stock and have equal voting rights with every other outstanding voting stock." ICA § 18(i). "Congress adopted Section 18(i) to address the use of 'various devices of control' by investment company insiders that were intended to effectively deny public shareholders ' any real participation in the management of their companies.'" Boulder No-Action Letter at *5, quoting S. Rep. No. 76-1775, at 7 (1940). Accordingly, "Section 18(i) addresses these concerns by ensuring that each investment company stockholder has a vote proportionate to his or her stockholdings." *Id.* Because SPE's by-law would deprive shareholders of their right to vote proportionate to all of their shares, it violates the statute.

SPE cannot claim the issue is not resolved by ICA § 18(i) because the by-law does not involve the issuance of "new" shares. Again, the Boulder No-Action Letter squarely addresses this argument:

> Under Section 18(i), therefore, every share of stock issued by an investment company must presently entitle the owner or holder to vote such share of stock for the election of directors. Nullifying the voting rights of an acquiring person with respect to control shares as contemplated by the MCSAA would be inconsistent with Section 18(i) because such acquiring person would no longer presently be entitled to vote such shares for the election of directors -- which is, of course, precisely the aim of the MCSAA. Our position gives practical effect to Section 18(i)'s suffrage guarantee.

Id. at *7.

SPE has not provided any rationale to revisit the *Boulder No-Action Letter*, and the Staff should not do so now.

The Continuing Director By-Law

We note that SPE has provided no justification, in the CEF context, for a by-law that defines a director as a "Continuing Director," and excludes directors elected as a result of a shareholder nomination from that definition and, therefore, deprives them of their power to fulfill their duties and responsibilities as directors. This provision openly challenges the findings and declarations of policy stated in ICA § 1. It appears that any board that approves such provision has acted in violation of the ICA as well as fiduciary duties owed under state law.

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As shown by the widespread adoption of majority voting by-laws, numerous CEF boards have taken anti-shareholder actions, the exact opposite of the purpose of ICA §§ 1 and 16(a). Failure of the Commission and Staff to take action in the face of these trends will harm CEF shareholders, most of whom are small retail investors, leading to the enrichment of CEF boards

and managers and the impairment of the CEF investment itself. We ask that the Staff use this opportunity to remind CEF boards and managers of their fiduciary obligations to act on behalf of shareholders, rather than themselves.

We appreciate your consideration, and would be pleased to discuss our comments or questions that the Commission or Staff may have. Please feel free to contact Adam Finerman, Thomas Fleming or Adrienne Ward at 212 451-2300.

Very truly yours,

Olshan Frome Wolosky LLP