

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31213 / August 15, 2014

In the Matter of	:	ORDER PURSUANT TO
Special Opportunities Fund, Inc.	:	SECTION 554(e) OF THE
	:	ADMINISTRATIVE PROCEDURE
	:	ACT OF 1946

On August 8, 2013, the Commission issued a notice (“Notice”) of an application for a declaratory order (“Application”) under Section 554(e) of the Administrative Procedure Act of 1946 (“APA”) filed by Special Opportunities Fund, Inc. (“SPE”), a closed-end management investment company (“closed-end fund”) registered under the Investment Company Act of 1940 (“1940 Act”) (Investment Company Act Release No. 30647). Brooklyn Capital Management, LLC (“Adviser”) is an investment adviser registered under the Investment Advisers Act of 1940 and currently serves as investment adviser to SPE. SPE seeks to rely on Section 12(d)(1)(F) of the 1940 Act, a conditional exemption from the limits set forth in Section 12(d)(1)(A) of the 1940 Act, to invest its assets in securities of other investment companies registered under the 1940 Act (“underlying funds”) that are closed-end funds.

The Notice stated that, absent a request for a hearing that is granted by the Commission, the Commission intends to issue an order under Section 554(e) of the APA declaring that SPE’s proxy voting procedure, described in the Notice, does not satisfy Section 12(d)(1)(F) of the 1940 Act. On August 28, 2013, SPE filed a request for a hearing (“SPE Hearing Request”). On August 29, 2013, Mr. Robert H. Daniels, a shareholder of SPE, also filed a request for a hearing (“Daniels Hearing Request,” and together with the SPE Hearing Request, “Hearing Requests”). The Commission has carefully considered the Hearing Requests and, as explained below, determined that none of the issues raised in the Hearing Requests warrants ordering a hearing on the Application.

BACKGROUND

Sections 12(d)(1)(A) and (F) of the 1940 Act

Section 12(d)(1)(A), in relevant part, makes it unlawful for any registered investment company (“acquiring fund”) to purchase or otherwise acquire any security issued by an underlying fund in excess of the limits specified in that section.¹ The legislative history of Section 12(d)(1)(A)

¹ Section 12(d)(1)(A) of the Act provides, in relevant part, that it shall be unlawful for any acquiring fund to purchase or otherwise acquire any security issued by an underlying fund if immediately after such purchase or acquisition: (i) the acquiring company owns more than 3% of the underlying fund’s

suggests that these restrictions were designed, in part, to address the concern that an acquiring fund could be used by an investment adviser, among others, as a vehicle to control or unduly influence, through voting, threat of redemption or otherwise, an underlying fund for its own or its affiliates' benefit and to the detriment of the shareholders of both funds.²

Section 12(d)(1)(F) provides a conditional exemption that may be used by an acquiring fund that seeks to invest a greater percentage of its assets in underlying funds than permitted under Section 12(d)(1)(A).³ One of the conditions in Section 12(d)(1)(F) requires that the acquiring fund “shall exercise voting rights by proxy or otherwise with respect to any security acquired pursuant to [Section 12(d)(1)(F)] in the manner prescribed by [Section 12(d)(1)(E)].”

Section 12(d)(1)(E)(iii), in turn, provides, in relevant part, that “the purchase or acquisition is made pursuant to an arrangement with the issuer of, or principal underwriter for, the issuer of the security whereby [the acquiring fund] is obligated either to seek instructions from its security holders with regard to the voting of all proxies with respect to such security and to vote such proxies only in accordance with such instructions, or to vote the shares held by it in the same proportion as the vote of all other holders of such security.” We refer to the first alternative as “Pass-Through Voting” or “Pass-Through Voting Condition.” We refer to the second alternative as “Mirror Voting.”

The conditions contained in the exemption provided by Section 12(d)(1)(F), and in particular the condition requiring voting in accordance with Section 12(d)(1)(E)(iii), attempt to minimize the influence that an acquiring fund's adviser, among others, may exercise over an underlying fund through voting.⁴

total outstanding voting stock; (ii) securities issued by the underlying fund have an aggregate value in excess of 5% of the value of the acquiring fund's total assets (“5% limit”); or if such securities, together with the securities of other investment companies, have an aggregate value in excess of 10% of the value of the acquiring fund's total assets (“10% limit”).

² U.S. SECURITIES AND EXCHANGE COMMISSION, INVESTMENT TRUSTS AND INVESTMENT COMPANIES, H.R. DOC NO. 279, 76th Cong., 1st Sess., pt. 3, at 2721-95 (1939).

³ Section 12(d)(1)(F) provides a conditional exemption from the 5% and 10% limits in Section 12(d)(1)(A) and permits an acquiring fund to purchase or otherwise acquire shares of an underlying fund if, immediately after the purchase or acquisition, the acquiring fund and all of its affiliated persons would not own more than 3% of the underlying fund's total outstanding stock.

⁴ See *Fund of Funds Investments*, Investment Company Act Release No. 27399 (June 20, 2006) at n.11 and accompanying text.

The Application

SPE has chosen to invest in the underlying funds in excess of the limits in Section 12(d)(1)(A) by relying on the conditional exemption provided by Section 12(d)(1)(F). On December 7, 2011, SPE's shareholders approved a proposal to "instruct the Adviser to vote proxies received by the Fund from any [underlying fund] on any proposal (including the election of directors) in a manner which the Adviser reasonably determines is likely to favorably impact the discount of such [underlying fund's] market price as compared to its net asset value" ("Voting Procedure").

On December 13, 2011, SPE filed the Application, subsequently amended on November 5, 2012, requesting a declaratory order pursuant to Section 554(e) of the APA stating that the Voting Procedure "does not cause it to be in violation of Section 12(d)(1) of the Act." Section 554(e) of the APA provides that "[t]he agency, with like effect as in the case of other orders, and in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty."

The Notice

The Notice stated that, "[i]n the Commission's preliminary view, SPE's Voting Procedure does not appear to be consistent with the purposes and policies behind Section 12(d)(1)(F) of the Act, or with the guidance that the Commission articulated in the [1971 Release, as defined below]. The Voting Procedure gives the Adviser broad discretion in voting the underlying funds' proxies and thus presents the potential for the Adviser to exercise undue influence over the management and policies of the underlying funds."⁵

The Commission stated in the 1971 Release that the Pass-Through Voting Condition in Section 12(d)(1)(F) "in effect, requires the fund holding company to make an arrangement with the issuer or principal underwriter of the issuer whereby sufficient proxy solicitation or other material may be transmitted to the fund holding company's security holders so that their instructions may be obtained."⁶ In the Notice, the Commission stated that "[t]his approach addresses the concern underlying the restrictions in Section 12(d)(1)(A) – that the fund of funds' investment adviser or another affiliate not exercise undue influence over the management or policies of an underlying fund – by placing the voting of the underlying fund's proxies in the hands of the fund of funds' shareholders (rather than its investment adviser)."

⁵ The Notice discussed that, shortly after Section 12(d)(1)(F) was enacted in 1970, the Commission issued a release providing guidance on the various provisions enacted by the new legislation, including specifically the Pass-Through Voting Condition. *Changes in the Investment Company Act of 1940 Made by the Investment Company Amendments Act of 1970 (P.L. 91-547) Relating to the Repeal and Modification of Exemptions for Certain Companies; The Pyramiding of Investment Companies and the Regulation of Fund Holding Companies; and Rescission of Rule 11b-1 under the Investment Company Act*, Investment Company Act Release No. 6440 (Apr. 6, 1971) ("1971 Release").

⁶ *Id.* at 4.

The Hearing Requests

The arguments raised in the Hearings Requests and the Commission's responses are discussed below.

Does There Need to Be "An Arrangement"?

The SPE Hearing Request disputes that the condition in Section 12(d)(1)(F) for the acquiring fund to exercise its voting rights "in the manner prescribed by subparagraph (E) of this subsection" includes the provision in Section 12(d)(1)(E)(iii) that the acquiring fund have "an arrangement with [the underlying fund or its principal underwriter] . . . whereby [the acquiring fund] is obligated either to [Pass-Through Vote or Mirror Vote]." The SPE Hearing Request also mischaracterizes the Notice as "stat[ing] that SPE can mirror vote without entering into an arrangement with the issuer."

In the Commission's view, as expressed in the Notice, the better reading of the statute is that Section 12(d)(1)(F)'s requirement to exercise voting rights "in the manner prescribed by [Section 12(d)(1)(E)]" references the entirety of Section 12(d)(1)(E), including the requirement that the acquiring fund have "an arrangement" with the underlying fund (or its principal underwriter) obligating the acquiring fund either to Pass-Through Vote or to Mirror Vote. Such a reading is more consistent with the principal purpose of Section 12(d)(1)(F)'s conditions, which is to maintain Section 12(d)(1)(A)'s protection of the underlying fund from control or influence by the acquiring fund or its affiliates. This purpose is evident in the fact that Section 12(d)(1)(F) prohibits an acquiring fund and its affiliated persons from acquiring more than 3% of the underlying fund's outstanding stock, provides that the underlying fund is not obligated to redeem more than 1% of securities acquired pursuant to Section 12(d)(1)(F) in any 30-day period, and requires the acquiring fund to vote in accordance with Section 12(d)(1)(E). By incorporating the provision in Section 12(d)(1)(E)(iii) that the acquiring fund have "an arrangement with [the underlying fund] whereby the [acquiring fund] is obligated" to Pass-Through Vote or Mirror Vote, Section 12(d)(1)(F) creates an obligation on the part of the acquiring fund to vote in a manner that protects the underlying fund from control or influence by the acquiring fund's adviser, consistent with the intent behind that provision. Reading such an obligation out of Section 12(d)(1)(F), as suggested in the SPE Hearing Request, in contrast, would eliminate that protection.

We note, however, that neither Section 12(d)(1)(E) nor the legislative history prescribes any particular type of "an arrangement." Thus, an acquiring fund that accomplishes either Pass-Through Voting (as interpreted by the Commission) or Mirror Voting with an underlying fund, and otherwise meets the conditions of Section 12(d)(1)(F), is unlikely to violate Section 12(d)(1)(A) due solely to an absence of a particular "arrangement" with the underlying fund.

SPE Shareholders' Support and Public Disclosure

The SPE Hearing Request points out that its Voting Procedure has "almost unanimous support" of its shareholders, who also will "have an opportunity each year to terminate the [Adviser's]

proxy voting discretion.” The SPE Hearing Request also notes that, unlike at the time of the 1971 Release, there is now public disclosure of the manner in which the proxies were voted.

These “salient facts,” as they are described in the SPE Hearing Request, however, do not negate the fact that the Proxy Voting Procedure gives the Adviser broad discretion in voting the underlying funds’ proxies and thus presents the potential for the Adviser to exercise undue influence over the management and policies of the underlying funds. SPE shareholders’ support for such broad discretion and after-the-fact disclosure of how that discretion was exercised do not minimize the potential for the Adviser to exercise undue influence over the management and policies of the underlying funds, which is the principal purpose behind the voting condition in Section 12(d)(1)(F).

The Breadth of the Adviser’s Voting Discretion

The SPE Hearing Request makes a conclusory assertion that “the discretion permitted by SPE’s Proxy Voting Procedure is limited; it is not ‘broad.’” The SPE Hearing Request also suggests that SPE shareholders’ “standing instructions” to the Adviser under the Voting Procedure satisfy the condition in Section 12(d)(1)(F) that the acquiring fund vote in the manner prescribed by Section 12(d)(1)(E).

As noted above, the Voting Procedure enables the Adviser, on any proposal from an underlying fund, to vote “in a manner which the Adviser reasonably determines is likely to favorably impact the discount of such [underlying fund’s] market price as compared to its net asset value.” The Voting Procedure does not limit the Adviser’s ability to vote on proposals from an underlying fund in the manner contemplated by Section 12(d)(1)(E). Rather, it affirms the Adviser’s discretion to decide how to vote on a proposal from an underlying fund without consulting SPE’s shareholders, contrary to the principal purpose of the voting condition in Section 12(d)(1)(F) to limit that discretion. Furthermore, reading Section 12(d)(1)(E)’s provision to “seek instructions” as allowing the “standing instructions” under the Voting Procedure as SPE does, would continue to allow the Adviser discretion to vote on proposals from an underlying fund. This creates a risk that the Adviser would unduly influence the underlying fund and undermine the basic purpose behind the voting condition in Section 12(d)(1)(F).

The Adviser’s Influence Over the Underlying Funds

The Daniels Hearing Request argues that the Adviser’s voting of an underlying fund’s shares held by SPE “to reduce the trading discount of a closed-end [underlying fund] does not constitute ‘undue’ influence” and suggests that the Commission should hold a hearing on this issue. We note, however, that Section 12(d)(1)(F) guards against influence by the acquiring fund’s investment adviser not by drawing any qualitative distinctions between undue and proper influence, but by preventing the adviser from voting in the first place and requiring Pass-Through Voting or Mirror Voting instead.

The Practicality of Pass-Through Voting as Described in the 1971 Release and the Consistency of Mirror Voting with the Adviser's Fiduciary Duty

The Daniels Hearing Request points out that SPE's portfolio consists of, among other things, shares in 46 underlying funds and that using Pass-Through Voting, as described in the 1971 Release, in SPE's situation therefore is "utterly impractical." In this regard, the Daniels Hearing Request says that "most individual investors in SPE would share my dismay at the prospect of constantly receiving [underlying fund] proxy statements at the rate of one per week, together with the obligatory stack of annual reports for these funds. And having received this flood of paper, the shares I hold in SPE would then (on a pro rata basis) allow me to vote 12 shares in the Aberdeen Israel Fund, 37 shares of Adams Express, 88 shares of Alpine Total Dynamic Dividend, and so forth down through the alphabet until I finally arrive at 65 shares of the Zweig Total Return Fund and must then start all over again."

The SPE Hearing Request further argues that "[b]y rejecting any realistic alternative to Mirror Voting, [the Commission's view of Pass-Through Voting as stated in the Notice] effectively prevents [the Adviser] from fulfilling its fiduciary duty to vote proxies in the best interest of SPE. . . . [The Adviser] cannot fulfill its fiduciary duty to vote SPE's proxies in the best interest of SPE by mindlessly Mirror Voting." The Daniels Hearing Request also suggests that Mirror Voting deprives SPE, as a shareholder of an underlying fund, of its right to participate in the management of the underlying fund.

Mirror Voting by the Adviser for the purpose of complying with the condition in Section 12(d)(1)(F) is essentially complying with a regulatory requirement and therefore would not violate the Adviser's fiduciary duty. It may well be, however, that Pass-Through Voting is impractical for SPE and that Mirror Voting is not optimal for SPE and the Adviser. This is not, however, a reason to read the conditions of Section 12(d)(1)(F) in a manner contrary to the purposes and policies underlying them. The conditions of Section 12(d)(1)(F) were intended primarily to protect the underlying fund from control or influence by the acquiring fund and its affiliates, including the acquiring fund's investment adviser. Pass-Through Voting, as interpreted by the Commission, and Mirror Voting guard against influence by the acquiring fund's adviser by placing the voting discretion on proposals from an underlying fund in the hands of someone else (*i.e.*, the acquiring fund's shareholders, in the case of Pass-Through Voting, or the other shareholders of the underlying fund, in the case of Mirror Voting). SPE's Voting Procedure, on the other hand, leaves the voting discretion with the Adviser and therefore operates contrary to the purpose of the voting condition in Section 12(d)(1)(F).

The Commission also notes that Section 12(d)(1)(F) is not an affirmative regulatory requirement, but a conditional exemption from the statutory limits of Sections 12(d)(1)(A) that any acquiring fund may or may not choose to use. To the extent that SPE and its shareholders believe that SPE should be permitted to invest in the underlying funds in excess of the limits in Section 12(d)(1)(A) of the 1940 subject to conditions different from those set forth in Section 12(d)(1)(F), SPE may seek an exemptive order pursuant to Sections 6(c) and 12(d)(1)(J) of the 1940 Act.⁷ The Daniels Hearing Request noted these provisions and requested that the

⁷ Section 12(d)(1)(J) provides that "[t]he Commission, by rule or regulation, upon its own motion or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or

Commission “grant an appropriate exemption.” Such an exemption is not, however, what SPE is seeking in the Application.⁸

THEREFORE, IT IS ORDERED that the requests for a hearing are denied.⁹

IT IS FURTHER ORDERED that SPE’s Voting Procedure is declared not to satisfy Section 12(d)(1)(F) of the 1940 Act.

By the Commission.

Kevin M. O’Neill
Deputy Secretary

any class or classes of persons, securities, or transactions from any provision of [Section 12(d)(1)], if and to the extent that such exemption is consistent with the public interest and the protection of investors.” Section 6(c) of the 1940 Act provides that “[t]he Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this subchapter or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter.”

⁸ Sections 6(c) and 12(d)(1)(J) provide for a Commission “order upon application.” The requirements for applications under the 1940 Act are set forth in Rule 0-2 under the 1940 Act. Any such order may or may not be granted based on the standards for exemption in Sections 6(c) and 12(d)(1)(J).

⁹ In a letter to the Secretary of the Commission, dated September 9, 2013, SPE requested that, should the Commission deny its hearing request, a stay be issued foreclosing any enforcement action pending the outcome of an appeal of the proposed order. Because there is no enforcement action on the issue currently pending, the Commission does not believe a stay is appropriate at this time.