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SEC Allows All Issuers to "Test-the-Waters"

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Capital Markets and Securities

On September 26, 2019, the Securities and Exchange Commission (the "SEC") announced the adoption of new Rule 163B under the Securities Act of 1933 (the "Securities Act"), which expands the permitted use of "test-the-waters" communications to all issuers, regardless of size or reporting status. The new rule, which the SEC proposed in February 2019, represents a substantial expansion of the "test-the-waters" provisions, which were previously available only to issuers that qualified as emerging growth companies ("EGCs").[1] The adoption of these rules will greatly facilitate the use of confidential marketing procedures to certain investors in securities offerings where the issuer does not already have an effective registration statement and is consistent with the continued efforts by the SEC to encourage registered securities offerings in the United States. In a statement issued commending the adoption of new Rule 163B, SEC Chair Jay Clayton stated "This benefits all investors – as a result of these communications, issuers can better identify information that is important to investors and enhance the ability to conduct a successful registered offering, ultimately providing both Main Street and institutional investors with more opportunities to invest in public companies that, in turn, provide ongoing disclosures to their investors."

Background

In 2012, as part of the Jumpstart Our Business Startups Act (the "JOBS Act"), Congress added a new Section 5(d) to the Securities Act, which permitted EGCs, or persons authorized to act on their behalf, to engage in oral or written communications with potential investors prior to or following the public filing of a registration statement "to determine whether those investors might have an interest in a contemplated securities offering." Prior to the JOBS Act, under Section 5 of the Securities Act, no offers of securities, written or oral, in a registered securities offering were permitted prior to the filing of the registration statement, subject to

[1] A company will qualify as an "emerging growth company" if it had total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and did not publicly sell any of its common equity securities pursuant to a registration statement prior to December 8, 2011. Emerging growth company status terminates under specified circumstances.

several limited SEC safe harbors.[2] Violation of these restrictions has been referred to as "gun jumping" and subjected issuers to potential liability under Section 12(a)(1) of the Securities Act. With the adoption of Rule 163B, the SEC has now extended the use of such "test-the-waters" communications to all issuers.

Rule 163B under the Securities Act

Rule 163B permits all issuers, or persons authorized to act on behalf of an issuer, including an underwriter, either prior to or following the filing of a registration statement, to engage in oral or written communications with potential investors that are, or that the issuer reasonably believes are, qualified institutional buyers ("QIBs") (as defined in Rule 144A) or institutional accredited investors ("IAIs") (as defined in Rule 501(a) of Regulation D), to determine whether such investors have an interest in the contemplated securities offering. The rule does not specify the steps an issuer must take to establish a reasonable belief regarding an investor's status as a QIB or IAI, and the SEC stated in the adopting release that issuers should continue to rely on the methods they currently use to make such determinations.

Communications that comply with Rule 163B are excluded from the definition of a free writing prospectus and will not need to be filed with the SEC.[3] In addition, Rule 163B will not require issuers to use legends with "test-the-waters" communications. However, the information in "test-the-waters" materials must not conflict with material information in the issuer's related registration statement, and communications under Rule 163B will be deemed to be "offers" under the Securities Act, and therefore subject to potential liability under Section 12(a)(2) of the Securities Act, as well as antifraud liability under Section 10(b) of the Securities Exchange Act of 1934. Further, the SEC Staff (the "Staff") may continue to request that copies of "test-the-waters" communications be furnished to the Staff as part of a registration statement review process.

Additionally, issuers subject to Regulation Fair Disclosure ("Regulation FD") will need to assess whether any information included in "test-the-waters" materials would trigger any public disclosure obligations under Regulation FD. In this regard, however, companies may comply with Regulation FD using established procedures that restrict investors that have received offering information from trading the company's securities until after the company has announced or abandoned the offering and disclosed any material non-public information that had been conveyed.

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[2] Section 2(a)(3) of the Securities Act defines "offer" broadly to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." The SEC excludes certain pre-filing communications from the definition of "offer" (*e.g.*, limited notices of proposed registered (Rule 135) and unregistered (Rule 135c) offerings; certain third-party research reports (Rules 137, 138 and 139); certain factual business information (Rule 169) and, in the case of reporting companies, limited forward-looking information (Rule 168); and certain communications made more than 30 days before a registration statement is filed (Rule 163A)).

[3] Historically, the SEC has not treated Section 5(d) communications as free writing prospectuses that are required to be filed. However, in order to avoid any implication that such communications would be treated differently than Rule 163B communications, the SEC also amended Rule 405 under the Securities Act to clarify that a written communication used in reliance on Rule 163B would not constitute a free writing prospectus.

Further, Rule 163B is non-exclusive, and issuers may continue to rely on other Securities Act communications rules or exemptions when communicating with investors about a contemplated securities offering.

All issuers, including non-reporting issuers, EGCs, non-EGCs, well-known seasoned issuers, and investment companies (including registered investment companies and business development companies), will be eligible to rely on Rule 163B following its effective date, which will be 60 days after publication of the adopting release in the Federal Register.

Conclusion

The SEC's adoption of Rule 163B and the related amendments builds on prior initiatives undertaken by the SEC to facilitate capital-raising transactions in the United States. The rule creates newfound flexibility for larger issuers to communicate more freely with institutional investors about a contemplated securities offering and to ascertain investor interest in a proposed offering on a confidential basis before conducting investor roadshows or publicly announcing the offering.

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