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SEC Expands "Testing-the-Waters" Communications to All Issuers

On September 26, 2019, the SEC adopted Rule 163B under the Securities Act of 1933, which permits ***all issuers*** to engage in "test-the-waters" communications with qualified institutional buyers ("QIBs") and institutional accredited investors ("IAIs") about a contemplated registered securities offering. The rule will become effective 60 days after it is published in the Federal Register.

The new rule, which was adopted largely in the form that it was proposed, levels the playing field by extending to all issuers the same accommodation for test-the-waters communications that the JOBS Act permitted for emerging growth companies ("EGCs"). Similar to the statutory provision in Section 5(d) of the Securities Act, Rule 163B will permit test-the-waters communications prior to, or following, filing a registration statement relating to the offering. By allowing issuers to gauge market interest in a contemplated registered offering, the new rule is intended to provide greater flexibility to all issuers in evaluating market interest before incurring the costs associated with such a registered offering.

New Securities Act Rule 163B

The new rule permits any issuer, or any person authorized to act on its behalf, including an underwriter, to engage in oral or written communications with QIBs or IAIs, either before or after filing a registration statement, to determine their interest in a contemplated registered 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)—are eligible to rely on the new rule.

There are no filing or legending requirements under the new rule. The rule is also non-exclusive, and an issuer will able be to rely concurrently on other Securities Act communications rules or exemptions when determining how, when, and what to communicate about a contemplated securities offering. The rule also states that Rule 163B communications constitute "offers" as defined in Section 2(a)(3) of the Securities Act, and are thereby subject to Section 12(a)(2) liability. Accordingly, information in a Rule 163B communication should not conflict with material information in the related registration statement.

Under the new rule, the solicitations must be made only to QIBs or IAIs. The investors solicited must actually meet the applicable standards as QIBs or IAIs, or the issuer must reasonably believe that they do. The Commission declined to provide a safe harbor for establishing such reasonable belief, noting that the standard is the same as currently in Rule 144A and Regulation D, and issuers will have the flexibility to use methods that are cost-effective but appropriate under the circumstances.

Practical Considerations

Non-Deal Road Shows. Although test-the-waters communications are most often associated with initial public offerings, the reach of the new rule is much broader than IPOs. It will allow any company – including established public companies – to communicate more freely with QIBs and IAIs through so-called "non-deal road shows," subject to compliance with Regulation FD.

Regulation FD. Although there is an exception in Regulation FD for communications made in connection with a registered offering that are included as part of the offering materials (e.g., prospectus, free writing prospectus, etc.), the Commission declined to extend such an exception to test-the-waters communications and so issuers subject to Regulation FD will need to be mindful of Regulation FD when conducting test-the-waters communications. Many QIBs and IAIs are

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the types of securities market professionals or shareholders covered by Regulation FD. As a result, issuers subject to Regulation FD will need to consider carefully whether any information in a test-the-waters communication, including information regarding a potential offering, would trigger disclosure obligations under Regulation FD or whether an exemption under Regulation FD would apply (such as the exception involving confidentiality agreements).

General Solicitation. In the adopting release, the Commission confirmed that the final rule does not modify existing rules on solicitation in conjunction with private placements and that its 2007 framework for analyzing how an issuer can conduct simultaneous registered and private offerings continues to apply. Where an issuer wishes to pursue a private placement before, during or after engaging in test-the-waters communications, it will need to consider whether the test-the-waters communication was conducted in such a way as to constitute a general solicitation. Unless the test-the-waters communication consists of "cold calling," it is likely that the party setting up the meeting will have the type of pre-existing, substantive relationship with the investor that would mitigate any general solicitation concerns.

Gun-jumping. There have been gun-jumping concerns expressed in situations where an issuer sells shares in an IPO to investors with whom the issuer discussed a private, so-called "crossover financing" close in time but before the filing of a registration statement. Rule 163B solves that concern under Section 5 of the Securities Act so long as the investors are QIBs or IAIs.

Status of Test-the-Waters Materials. The new rule and a related amendment to the definition of "free writing prospectus" in Rule 405 of the Securities Act make clear that test-the-waters materials are not free writing prospectuses and need not be filed. This position applies whether the issuer is relying on the statutory provision in Section 5(d) or new Rule 163B. Issuers should, however, continue to expect that the Staff in the Division of Corporation Finance may request, in connection with its review of a registration statement, copies of any materials used in test-the-waters meetings.

Redistribution of Test-the-Waters Materials. Another commenter raised a concern about the implications of a QIB or IAI passing test-the-waters information on to nonqualified parties. In the adopting release, the Commission stated that where an issuer has taken reasonable steps to prevent test-the-waters communications from being shared with non-QIBs and non-IAIs and such information is nonetheless shared, such circumstances, in themselves, would not give rise to Section 5 liability for the issuer or the need for any cooling-off period. This guidance thus highlights the benefits of having reasonable controls and procedures in place to avoid sharing test-the-waters communications with non-QIBs and non-IAIs.

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