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Legal Update

Testing the Waters for All – New Rule 163B Expands TTW to All Issuers

On September 26, 2019, the US Securities and Exchange Commission (Commission) extended the ability to test the waters to all issuers by adopting the highly anticipated new Rule 163B under the Securities Act of 1933 (the Securities Act).[1] The new rule allows any issuer, or any person acting on the issuer's behalf, to engage in test the waters communications with potential investors that are reasonably believed to be institutional accredited investors (IAIs) and qualified institutional buyers (QIBs), either prior to or following the date of filing of a registration statement relating to the offering, without violating the Securities Act's "gun jumping" rules. Prior to Rule 163B, testing the waters was limited to emerging growth companies (EGCs) only.

Since the Jumpstart Our Business Startups (JOBS) Act was enacted in 2012, EGCs have benefited from the opportunity to test the waters with investors and gauge interest in a potential offering. Title I of the JOBS Act added Section 5(d) to the Securities Act in order to provide that certain communications made by EGCs or persons acting on their behalf with IAIs and QIBs, either prior to or following the filing of a registration statement, would not constitute "gun jumping."

Although most issuers that have undertaken IPOs in recent years are EGCs and already benefit from the ability to communicate with institutional investors, the notion of extending this communications safe harbor to other issuers has been viewed as providing greater flexibility without raising any investor protection concerns.

Under the new rule, these communications can be oral or written, are not required to be filed with the Commission, and are not required to bear any legends. Since written communications are permitted, the Commission also amended Rule 405 in order to exclude written communications used in reliance on Rule 163B or Section 5(d) of the Securities Act from the definition of "free writing prospectus." Of course, information shared in any test the waters communication must not conflict with material information included in the registration statement for the offering. Although the Commission acknowledged that "circumstances or messaging" may change between the time a pre-filing Rule 163B communication is made and the time a registration statement is filed, statements made in any 163B communications must not contain material misstatements or omissions at the time such statements are made.

Although similar to Section 5(d) in many respects, unlike Section 5(d), Rule 163B requires only a reasonable belief that the investors receiving communications are QIBs or IAIs rather than

requiring that such investors in fact fall into those categories. Neither Rule 163B nor the Commission's adopting release specifies the steps that could or must be taken to establish a reasonable belief regarding investor status. This approach is intended to provide issuers with flexibility to use cost-effective methods that are appropriate to the facts and circumstances.

Importantly, the Commission's adopting release makes clear that while communications benefiting from Rule 163B do not violate the gun-jumping rules, such communications are "offers" under the Securities Act and thus are subject to liability under Section 12(a)(2) under the Securities Act and other anti-fraud provisions such as Rule 10b-5 under the Securities Exchange Act of 1934.

The Commission confirmed that an issuer could test the waters without such communications constituting a general solicitation and, thus, preserve its ability to pursue a private placement in lieu of a registered offering even after testing the waters for a registered offering. However, the Commission also cautioned that whether a test the waters communication would also be a general solicitation would depend on the facts and circumstances.

The Commission noted that issuers subject to Regulation FD will need to consider whether such communications trigger any Regulation FD obligations. Presumably, an issuer could obtain a confidentiality undertaking in order to ensure compliance with Regulation FD. This is interesting because a significant percentage of follow-on offerings are undertaken on a "wall-crossed" or confidential basis with investors that have undertaken to keep information confidential. Time will tell whether this will change market practice for such transactions.

Once effective, the new rule is available to be relied upon by all issuers, including reporting and non-reporting companies, investment companies, such as closed-end funds, and business development companies.

The new rule is a non-exclusive safe harbor. For certain issuers, for example, well-known seasoned issuers (WKSIs), other communications safe harbors already may be available, such as Rule 163.

Some of the primary beneficiaries of the new rule will be:

- Non-WKSIs that do not have a registration statement on file that want an underwriter to wall-cross investors about a potential securities offering (without Rule 163B, such an issuer would need a registration statement on file with the underwriter's name included);
- Issuers that have a registration statement on file with the Commission but would like to discuss the issuance of a class of securities not covered by the registration statement; and
- Non-EGC issuers in the first year after their IPO that are eligible to confidentially submit registration statements for follow-on offerings (without Rule 163B, such issuers could not contact investors until a registration statement was publicly filed).

The new rule will become effective 60 days after the publication of the Commission's adopting release in the *Federal Register*.

Endnotes

[1] *Available at:* https://www.sec.gov/rules/final/2019/33-10699.pdf

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