

SEC Extends “Testing-the-Waters” to All Issuers

October 1, 2019

Background. On September 25, 2019, the Securities and Exchange Commission (the “SEC”) adopted new Rule 163B under the Securities Act of 1933, as amended (the “Securities Act”), which permits oral and written communications between prospective issuers and certain potential investors prior to or following the filing of a registration statement, to determine whether such potential investors might have an interest in a contemplated registered securities offering. Historically, the “gun-jumping” provisions of Section 5 of the Securities Act restricted oral and written communications with investors prior to the filing of a registration statement. In 2012, Congress passed the Jumpstart Our Business Startups (“JOBS”) Act, which, pursuant to Section 5(d) of the Securities Act, created the “testing-the-waters” (“TTW”) exception to the gun-jumping prohibitions of Section 5 pursuant to which emerging growth companies (“EGCs”) are permitted to engage in oral or written communications with potential investors who are either qualified institutional buyers (“QIBs”) or institutional accredited investors (“IAIs”) prior to or after the filing of a registration statement. As adopted, Rule 163B extends these TTW provisions to allow all prospective issuers, and any person authorized to act on behalf of a prospective issuer, to communicate with QIBs and IAIs in order to gauge investor interest prior to filing a registration statement. The final rule will become effective 60 days after the rule’s publication in the Federal Register.

Summary of Rule 163B.

- **Extension of TTW Provisions to All Issuers.** Rule 163B permits all issuers, including EGCs, well-known seasoned issuers (“WKSIs”) and investment companies, to engage in oral or written communications prior to or following the issuer’s filing of a registration statement with respect to its securities. Rule 163B also protects communications between potential investors and parties acting on behalf of an issuer, such as underwriters.
- **Permitted Recipients of Pre-Filing Communications.** Rule 163B exempts communications made to potential investors that are, or that the issuer or person acting on its behalf reasonably believes are, QIBs or IAIs. In an effort to maintain flexibility depending on the applicable facts and circumstances with respect to a

particular issuer or offering, Rule 163B does not specify the steps an issuer needs to take to establish a reasonable belief regarding investor status. In the adopting release, the SEC encourages issuers to continue to implement methods they currently use to establish a reasonable belief with regard to investor status.

- **Legending or Filing Requirements.** Rule 163B communications do not need to be filed with the SEC or include any specified legend. In connection with the adoption of Rule 163B, the SEC is also amending Rule 405 to exclude Rule 163B communications and Section 5(d) communications from the definition of “free writing prospectus” (the SEC is formalizing its view that Section 5(d) communications are not free writing prospectuses).

Regulation FD. Issuers subject to Regulation FD should bear in mind that TTW communications may implicate disclosure obligations under Regulation FD if the communication constitutes disclosure of material nonpublic information to a covered party. Affected issuers should therefore ensure that they have appropriate Regulation FD controls in place.

Private Placement. Issuers should exercise care when engaging in Rule 163B communications if execution of a private placement in close proximity to an aborted registered offering is a possibility. If an issuer decides to pursue a private placement of securities instead of a registered offering immediately after engaging in a Rule 163B communication, the issuer should evaluate the facts and circumstances surrounding such Rule 163B communication to determine whether it would be considered a “general solicitation.”

Non-Exclusivity. Rule 163B is non-exclusive. Accordingly, an issuer would be able to rely on other Securities Act communications rules or exemptions from the registration requirements of the Securities Act for the purpose of making communications related to a contemplated securities offering. Notwithstanding such non-exclusivity, an issuer that first utilizes Rule 163B before utilizing another exemption must ensure compliance with the applicable conditions of such other exemption at the time of use. For example, if a WKSI communicates with potential QIB investors pursuant to Rule 163B before later extending its communications to potential non-QIB and non-IAI investors pursuant to Rule 163, such issuer must comply with the “free writing prospectus” legending requirements of Rule 163 in connection with any communication with such potential non-QIB and non-IAI investors in order to avail itself of that rule.

Securities Act Liability. While Rule 163B permits pre-filing communications in connection with a contemplated offering, such communications are still considered “offers” as defined in Section 2(a)(3) of the Securities Act. As such, Rule 163B communications are subject to liability under Section 12(a)(2) of the Securities Act in

addition to the anti-fraud provisions of federal securities laws. Additionally, the SEC included guidance in the adopting release indicating that information contained in Rule 163B communications must not conflict with material information contained in the related registration statement. This guidance is intended to serve as a general reminder that Rule 163B communications must be made in compliance with all applicable provisions of federal securities laws. Finally, consistent with its treatment of EGC TTW communications made pursuant to Section 5(d), the SEC may, in connection with its review of an issuer's registration statement, request that the issuer provide it with any TTW communications it has made with respect to the offering for review.

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Please do not hesitate to contact us with any questions.

NEW YORK



Eric T. Juergens
etjuergens@debevoise.com



Matthew E. Kaplan
mekaplan@debevoise.com



Peter J. Loughran
pjloughran@debevoise.com



Paul M. Rodel
pmrodel@debevoise.com



Devon Klein
dklein1@debevoise.com