

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

A Lexis Practice Advisor® Practice Note by
Anna T. Pinedo and John R. Ablan, Mayer Brown LLP



Anna T. Pinedo
Mayer Brown LLP



John R. Ablan
Mayer Brown LLP

Introduction

This article discusses the new Rule 163B adopted by the US Securities and Exchange Commission (SEC). On September 26, 2019, the SEC extended the ability to test the waters to all issuers by adopting the highly anticipated new Rule 163B under the Securities Act of 1933, as amended (the Securities Act). 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) or 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, the ability to test the waters was limited to emerging growth companies (EGCs) only.

Rule 163B represents a significant expansion of the testing the waters rules and is a continuation of the SEC's prior actions to extend reforms available for EGCs to all issuers. In 2017, for example, the SEC began to allow all issuers to submit initial registration paperwork confidentially with the SEC, an accommodation that was, until then, only available to EGCs.

For further information on the federal securities laws applicable to communication and publicity matters involving companies conducting securities offerings, see [IPOs, Follow-On Offerings, Road Shows, and Earnings Guidance: FAQs on Publicity, Communications, and Offers](#). For a general overview of, and links to available resources regarding, these communication and publicity issues, see [Publicity and Communications Resource Kit](#) and [Initial Public Offerings Resource Kit](#).

Background

Absent an exemption, Section 5(c) of the Securities Act prohibits written or oral offers of securities prior to the filing of a registration statement. Section 5(b)(1) further requires that, once a registration statement has been filed, issuers use a prospectus that meets the requirements of Section 10 of the Securities Act for any written offers of securities. These provisions are collectively known as the gun-jumping rules.

In 2012, Congress passed the Jumpstart Our Business Startups Act (JOBS Act), which established EGCs as a new category of issuer and added Section 5(d) to the Securities Act. Section 5(d) permits EGCs and persons authorized to act on their behalf to participate in oral or written communications with potential investors that are QIBs or IAIs to determine if those investors may be interested in a potential securities offering. Communications by EGCs made

pursuant to Section 5(d) are excluded from the gun-jumping rules. The JOBS Act utilized the same definition of qualified institutional buyer as Rule 144A under the Securities Act. In general, a QIB is a specified institution that, acting for its own account or for the accounts of other QIBs, owns and invests on a discretionary basis at least \$100 million in securities of unaffiliated issuers. In addition, banks and certain other specified financial institutions must also have a net worth of at least \$25 million. Finally, a registered broker-dealer is a QIB when it owns and invests on a discretionary basis at least \$10 million in securities of issuers that are not affiliated with the broker-dealer. An IAI refers to any institutional investor that qualifies as an accredited investor under Rule 501 of Regulation D under the Securities Act. An EGC is defined under the JOBS Act as a company with annual gross revenues of less than \$1.07 billion during its most recent fiscal year. With some exceptions, an EGC retains its status as long as it has total annual gross revenues less than \$1.07 billion and either has not completed an initial public offering (IPO) or has not yet reached the fifth anniversary of its IPO.

Initial Guidance

Rule 163B extends Section 5(d)'s testing-the waters provisions to all issuers and permits any issuer, or any person authorized to act on its behalf, to engage in oral or written communications with potential investors that are, or are reasonably believed by the issuer to be, QIBs or IAIs, either prior to or following the filing of a registration statement, to determine whether such investors might have an interest in a contemplated registered securities offering. The rule provides an exemption from Section 5(b)(1) and Section 5(c) of the Securities Act for such communications. The adopting release also amends Rule 405 to exclude communications used in reliance on either Rule 163B or Section 5(d) from the definition of free writing prospectus.

Rule 163B contains no legend or filing requirements, but does require that testing-the-waters communications not conflict with information in the registration statement for the related offering. Although the SEC 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 Rule 163B communications must not contain material misstatements or omissions at the time such statements are made. Rule 163B is non-exclusive, meaning an issuer could also rely on other exclusions or exemptions to the gun-jumping rules when determining how to communicate about a potential securities offering. 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. This reasonable belief language is a beneficial change from Section 5(d), since a person relying upon that provision could face potential liability should some investors ultimately not qualify as a QIB or IAI. Neither Rule 163B nor the SEC'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.

The SEC 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 SEC also cautioned that whether a Rule 163B communication would also constitute a general solicitation would depend on the facts and circumstances.

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

Benefits of the Rule

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

- Well-known seasoned issuers (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 SEC 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)

One limitation to the previous bullet points is Regulation FD, which generally requires public companies to publically disclose any material nonpublic information that has been selectively disclosed to certain securities market professionals or shareholders. QIBs or IAIs often fall under the category of securities market professionals to whom selective disclosure cannot be provided. While a potential

problem for issuers, Rule 100(b)(2) of Regulation FD provides an exemption from its requirements if the selective disclosure was made to a person who owes a duty of trust or confidence to the issuer or to a person who expressly agrees to maintain the disclosed information in confidence. If issuers or underwriters sought to rely on Rule 163B, they could ensure compliance with Regulation FD by requiring investors to enter into a confidentiality undertaking prior to disclosing any information about the offering. This technique is currently used for confidentially marketed public offerings and is known as wall-crossing. Should the issuer not ultimately move forward with the planned offering, it could then publicly disclose information about its communications with potential investors to release those investors from the terms of the confidentiality agreement (commonly referred to as cleansing).

While some market participants already engage in wall-crossing with investors to assess interest in a potential offering, currently all issuers, other than EGCs, must have a

registration statement on file prior to having underwriters communicate with investors about an offering on their behalf. Although WKSIs currently benefit from rules which permit them to make certain offers during the pre-filing period, those rules do not extend to underwriters acting on the WKSIs' behalf. Rule 163B removes these constraints and allows all issuers as well as underwriters to participate in wall-crossing communications in the pre-filing period.

Looking Ahead

The new rule will become effective on December 3, 2019, which is 60 days after the publication of the SEC's adopting release in the Federal Register.

Anna T. Pinedo, Partner, Mayer Brown LLP

Anna Pinedo is a partner in Mayer Brown's New York office and a member of the Corporate & Securities practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs and consumer finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.

In the derivatives area, Anna counsels a number of major financial institutions acting as dealers and participants in the commodities and derivatives markets. She advises on structuring issues as well as on regulatory issues, including those arising under the Dodd-Frank Act. Her work focuses on foreign exchange, equity and credit derivatives products, and structured derivatives transactions. Anna has experience with a wide range of transactions and structures, including collars, swaps, forward and accelerated repurchases, forward sales, hybrid preferred stock and off-balance sheet structures. She also has advised derivatives dealers regarding their Internet sites and other Internet and electronic signature/delivery issues, as well as on compliance matters.

John R. Ablan, Associate, Mayer Brown LLP

John R. Ablan is an associate in Mayer Brown's Chicago office and a member of the Corporate & Securities group. As a member of the firm's Capital Markets group, John's practice focuses on representing underwriters and issuers in a wide variety of securities offerings, including public and private offerings of high yield and investment grade debt, equity, as well as tender and exchange offers.

John is an experienced securities attorney. In his prior roles he has served both as in-house counsel at a major investment bank located in New York as well as a capital markets associate for a major, full service law firm located in New York.

John received his JD from Vanderbilt University Law School, he received his MSc, with distinction, from the London School of Economics and Political Science and his AB, magna cum laude, from Washington University in St. Louis. John is admitted to practice in the states of New York and Illinois.

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