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EVERYONE JUMP IN! ALL ISSUERS WILL BE ALLOWED TO "TEST-THE-WATERS"

To Our Clients and Friends:

On September 26, 2019, the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") announced[1] that it has adopted a new rule, Rule 163B[2] under the Securities Act of 1933 (the "Securities Act"), that allows all issuers to "test-the-waters." This accommodation, which had previously been available only to emerging growth companies ("EGCs"), allows issuers or authorized persons (*e.g.*, underwriters) to engage in discussions with, and provide written offering material to, certain institutional investors prior to, or following, the filing of a registration statement, to determine market interest in potential registered securities offerings. Rule 163B will become effective 60 days after publication in the Federal Register.

In connection with the adoption of Rule 163B, Chairman Jay Clayton noted in a public statement[3] that test-the waters communications "have proven to be a popular and cost-effective means for evaluating market interest before incurring the costs associated with an initial public offering." Chairman Clayton contended that Rule 163B will provide "both Main Street and institutional investors with more opportunities to invest in public companies." This is consistent with one of the tenets of the SEC's current Strategic Plan[4] to increase the number of public companies for the benefit of Main Street investors.

The SEC initially proposed a new rule allowing all issuers to test-the-waters (the "Proposed Rule") on February 19, 2019.[5] Under the Proposed Rule, any issuer or authorized person (*e.g.*, an underwriter) would be permitted to engage in oral or written communications with potential investors that the issuer reasonably believes are qualified institutional buyers ("QIBs"), as that term is defined in Rule 144A, or institutional accredited investors ("IAIs"). In the Proposed Rule, the SEC stated that the new rule would "help issuers better assess the demand for and valuation of their securities," which may in turn "enhance the ability of issuers to conduct successful offerings and lower their cost of capital."

Summary of Rule 163B

The key provisions of Rule 163B are outlined below. Rule 163B in the form adopted by the SEC is largely consistent with the Proposed Rule, with few exceptions as noted. The requirements and liability associated with Rule 163B are also generally consistent with Section 5(d) of the Securities Act, which allows EGCs to engage in testing-the-waters. It expands on, and modifies the provisions of, Rule 163, which is available only to well-known seasoned issuers ("WKSIs").

Exemption Allowing Test-the-Waters Communications

- ***163B communications considered "offers."*** Test-the-waters communications under Rule 163B will be considered "offers" under Section 2(a)(3) of the Securities Act, and as a result, will still be subject to Section 12(a)(2) liability, as well as the anti-fraud provisions of the Federal securities laws.

- ***No filing requirement***. In contrast to Rule 163, issuers will not be required to file Rule 163B test-the-waters communications with the SEC or include any special legend on the communication. The SEC noted that it could request copies of test-the-waters communications when reviewing a registration statement, and we would expect offering-related comment letters to include such requests consistent with the current practice. Also, written communications used in reliance on Rule 163B will not constitute free writing prospectuses, and the SEC clarified that Section 5(d) written communications also are not "free writing prospectuses" under Rule 405 and are exempt from the prospectus filing requirement under Rule 424(b).

- ***Inconsistency with the registration statement***. Information in a test-the-waters communication must not conflict with material information in the related registration statement. In response to commenters' concerns related to the possibility of having materials in the pre-filing test-the-waters communications that are different from the information in the registration statement, the SEC clarified in the proposing release for Rule 163B that its statement regarding issuers having consistent information in the Rule 163B communications and the registration statement is "intended to provide guidance to issuers" and is not a condition to determine the availability of Rule 163B. The SEC, however, emphasized the importance of not having any material misstatements or omissions in the Rule 163B communications.

- ***Regulation FD applies to test-the-waters communications***. When providing test-the-waters communications to potential or current investors, issuers subject to Regulation FD must consider whether any information in such communication triggers any obligations under Regulation FD where material nonpublic information needs to be publicly disclosed or shared only on a confidential basis.

- ***General solicitation***. In response to commenters' concerns related to the possibility of the Rule 163B communications being viewed as a general solicitation that could disqualify an issuer from conducting a private placement instead of a registered offering, the SEC stated that whether such communications would constitute a general solicitation depends on the facts and circumstances, which issuers must evaluate when contemplating a subsequent private placement.

- ***Elimination of "anti-evasion" language in the Proposed Rule***. The SEC has removed "anti-evasion" language in the Proposed Rule that would make the rule unavailable for any communication that are "in technical compliance with the rule," but "is part of a plan or scheme to evade the requirements of the Section 5 of the [Securities] Act." The SEC noted that this removal was in light of concerns expressed by certain commenters that the anti-evasion language creates more confusion and may deter issuers from using Rule 163B.

Scope of Eligible Issuers

All issuers—including non-reporting issuers, EGCs, non-EGCs, WKSIs and investment companies (including registered investment companies and business development companies ("BDCs"))—are eligible to rely on Rule 163B. Under Rule 163B as adopted, any issuer, or person authorized to act on behalf of the issuer, is permitted to engage in exempt oral or written communications with qualified potential investors.In a significant expansion from Rule 163, which permitted communications only by the issuer, Rule 163B also applies to communications by "persons authorized to act on behalf of" the issuer, which means that it can be relied on by an issuer's investment bankers and other advisors.

Investor Status

Consistent with the Proposed Rule, Rule 163B permits an issuer to engage in pre- and post-filing solicitations of interest with potential investors that are, or that the issuer reasonably believes to be, QIBs or IAIs. A QIB generally is a specified institution that, acting for its own account or the accounts of other QIBs, in the aggregate, owns and invests on a discretionary basis at least $100 million in securities of unaffiliated issuers. An IAI is any institutional investor that is also an accredited investor, as defined in paragraph (a) of Rule 501 of Regulation D. Under Rule 163B, any potential investor solicited must meet, or issuers must reasonably believe that the potential investor meets, the requirements of the rule.

- ***Limiting communications to QIBs and IAIs***. Despite recommendations from several commenters that the SEC consider expanding the class of eligible investors that may be engaged with in test-the-waters communications, the Commission limited the class of eligible investors to QIBs and IAIs in Rule 163B, which is consistent with the Proposed Rule.

- ***Reasonable belief standard***. Rule 163B does not specify the steps that an issuer could or must take to establish a reasonable belief regarding investor status or require the issuer to verify investor status. In response to comments regarding this standard, the SEC stated that "by not specifying the steps an issuer could or must take to establish a reasonable belief as to investor status, this approach is intended to provide issuers with the flexibility to use methods that are cost-effective but appropriate in light of the facts and circumstances of each contemplated offering and each potential investor."

Non-Exclusivity of Rule 163B

The Commission explicitly stated that Rule 163B is non-exclusive and an issuer is able to rely concurrently on other Securities Act communications rules or exemptions when determining how, when, and what to communicate related to a contemplated securities offering.

Use by Investment Companies

Issuers that are, or that are considering becoming, registered investment companies or BDCs (collectively, "funds") are also eligible to engage in test-the-waters communications under Rule 163B. The Commission will not require any different filing, legending, or content requirements for funds' test-the-waters communications under Rule 163B.

Considerations When Using New Rule 163B

While the SEC is hopeful that Rule 163B "will allow issuers to consult effectively with investors as they evaluate market interest in a contemplated registered securities offering before incurring the costs associated with such an offering, while maintaining adequate investor protections," issuers must still be wary of certain restrictions and use the test-the-waters communications with caution.

As the SEC emphasized in Rule 163B, issuers must ensure that there are no material misstatements or omissions in any test-the-waters communications. Even though the SEC acknowledged concerns regarding possible inconsistencies between materials in Rule 163B communications and information in the corresponding registration statements, such communications are still subject to Section 12(a)(2) liability, as well as anti-fraud provisions.

In addition, given that Rule 163B communications will be subject to the requirements of Regulation FD, issuers that are subject to Regulation FD will need to determine whether Rule 163B communications will trigger Regulation FD's requirements and whether to share the information only on a confidential basis through a wall-cross approach (subject to possible need for cleansing), similar to current practice in confidentially marketed offerings.

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[1] https://www.sec.gov/news/press-release/2019-188

[2] https://www.sec.gov/rules/final/2019/33-10699.pdf

[3] https://www.sec.gov/news/public-statement/clayton-2019-09-26-three-rulemakings

[4] For more information on the Strategic Plan, see Gibson, Dunn & Crutcher LLP, "The SEC Adopts Strategic Plan for 2018-2022," *available at* http://SecuritiesRegulationMonitor.com/Lists/Posts/Post.aspx?ID=340

[5] For more information on the Proposed Rule, see Gibson, Dunn & Crutcher LLP, "SEC Proposes Long-Awaited Expansion of "Test-the-Waters" to All Issuers - Use With Caution," *available at* https://www.securitiesregulationmonitor.com/Lists/Posts/Post.aspx?ID=352

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact any member of the Gibson Dunn team, the Gibson Dunn lawyer with whom you usually work in the firm's Capital Markets practice group, or the authors:

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