

SEC Adopts Rule 163B Expanding “Test-the-Waters” Communications to All Issuers

On September 25, 2019, the Securities and Exchange Commission (the “SEC”) adopted Rule 163B under the Securities Act of 1933, as amended (the “Act”), to expand the use of “test-the-waters” (“TTW”) communications, which were previously available only to emerging growth companies (“EGCs”), to all issuers (or any person authorized to act on their behalf).¹

I. Background

Section 5 of the Securities Act and related rules restrict communications by issuers during various phases of the securities offering process. For example, Section 5(c) generally prohibits written and oral offers prior to the filing of a registration statement, absent an exemption,² and Section 5(b)(1), which applies once a registration statement is filed, limits written offers to a “statutory prospectus” that includes the information required by Section 10 of the Securities Act.³ A violation of these provisions is known as “gun-jumping.”⁴ Rule 163B provides an exemption from Section 5(b)(1) and Section 5(c) of the Act for TTW communications to qualified institutional buyers (“QIBs”)⁵ or institutional accredited investors (“IAIs”)⁶. Rule 163B is an expansion on the existing Section 5(d) TTW communications exemption. Under Section 5(d), only EGCs (and their authorized agents) are permitted to engage in oral or written communications with QIBs and IAIs to “test-the-waters” before or after the filing of a registration statement to determine investor interest in a contemplated registered offering.⁷

II. Rule 163B Scope

Rule 163B permits all issuers, including non-EGCs, and any person authorized to act on their behalf (including underwriters and dealers), to engage in oral or written communications with certain potential investors made before or after the filing of a registration statement with respect to such securities to determine whether such investors might have an interest in a contemplated registered securities offering.⁸

The SEC generally retained the rule as proposed in SEC Release No. 33-10607 and outlined in our previous

¹ For the full text of the release, see Securities and Exchange Commission, Solicitations of Interest Prior to a Registered Public Offering, SEC Release No. 33-10699, available at <https://www.sec.gov/rules/final/2019/33-10699.pdf> (September 25, 2019) [hereinafter the “Adopting Release”].

² See 15 U.S.C. 77e(c).

³ See 15 U.S.C. 77e(b)(1).

⁴ Securities and Exchange Commission, Solicitations of Interest Prior to a Registered Public Offering, SEC Release No. 33-10607 at 7, available at <https://www.sec.gov/rules/proposed/2019/33-10607.pdf> (February 19, 2019) [hereinafter the “Proposing Release”].

⁵ A QIB is an entity meeting the requirements set forth in 17 CFR 230.144A (“Rule 144A”), including any entity within certain specified categories, acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers not affiliated with the entity (or \$10 million for a broker-dealer).

⁶ An IAI is an institution that complies with one of the accredited investor categories as described in 17 CFR 230.501 (“Rule 501”) of Regulation D under the Act.

⁷ See 15 U.S.C. 77e(d).

⁸ *Adopting Release* at 103-04.

Firm Memorandum on March 22, 2019.⁹

Key parts of Rule 163B as adopted are:

- TTW available to all issuers and their agents: All issuers (including non-EGCs) or any person authorized to act on their behalf (including underwriters or dealers) are permitted to engage in TTW communications;
- Timing: TTW communications may be made prior to or after the filing of a registration statement with the SEC;
- Only for certain investors: TTW communications may only be made to prospective investors that are, or are reasonably believed to be, QIBs or IAIs;
- No verification requirement: Issuers and their agents are not required to verify an investor's status so long as they "reasonably believe" the potential investor meets the QIB or IAI requirements¹⁰;
- No legend or filing requirements: TTW communications are not required to be filed with the SEC, and there are no specific legends required;
- Non-exclusive: The rule is non-exclusive, meaning issuers can rely on other exemptions; and
- Liability: Any TTW communication would constitute an "offer" under the SEC rules and thus be subject to liability under the federal securities laws.

In adopting Rule 163B, the SEC noted that the "staff in the Division of Corporation Finance anticipates requesting, in connection with its review of a registration statement, that any test-the-waters communications used in connection with the offering be furnished to the staff for review, as is currently its practice when reviewing offerings conducted by EGCs."¹¹

The SEC also noted that although such Rule 163B TTW communications "would be exempt from Section 5 of the Securities Act, issuers nevertheless must take care to ensure that they are made in compliance with other provisions of the federal securities laws."¹² Recognizing that statements may change between the time of the TTW communication and the filing of the registration statement, the SEC explained that "it is important to keep in mind that statements made in the test-the-waters materials and in the related registration statement, if filed, must not contain material misstatements or omissions *at the time the statements are made*."¹³

III. Minor Differences from Proposed Rule 163B

The SEC adopted the proposed rule with only minor variations.

The SEC adopted the recommendations of several commenters to eliminate the "anti-evasion" language from paragraph (a)(2) of the proposed rule as it was "unclear how permissible communications could be part of a scheme to evade Section 5 of the Act and that such language could give rise to confusion or uncertainty."¹⁴

⁹ See *Proposing Release*; Cahill Gordon & Reindel LLP, Firm Memorandum – [SEC Proposes to Expand "Test-the-Waters" Communications to All Issuers](#) (March 22, 2019).

¹⁰ While the SEC did not specify specific steps in order to establish a "reasonable belief," the SEC believes "that issuers should continue to rely on the methods that they currently use to establish a reasonable belief with respect to an investor's status as a QIB or IAI pursuant to Rule 144A or Rule 501(a)." *Adopting Release* at 32.

¹¹ *Id.* at 20.

¹² *Id.*

¹³ *Id.* (emphasis added).

¹⁴ *Id.* at 16. Proposed Rule 163B(a)(2) read: "This rule is not available for any communication that, although in technical compliance with this rule, is part of a plan or scheme to evade the requirements of section 5 of the Act." See *Proposing*

In the Adopting Release, the SEC clarified that it has not historically treated Section 5(d) TTW communications as free writing prospectuses that are required to be filed.¹⁵ However, as one commenter noted, including Rule 163B as an exemption from the definition of “free writing prospectus” under Rule 405 could create confusion that Section 5(d) TTW communications are free writing prospectuses under Rule 405 simply because they are not specifically exempted.¹⁶ Therefore, the SEC amended Rule 405 to exclude both Section 5(d) TTW communications and Rule 163B TTW communications.¹⁷

IV. Conclusion

With the adoption of Rule 163B, the SEC expanded certain benefits previously afforded to EGCs to all issuers and their authorized agents. The SEC believes that the benefits of Rule 163B should aid issuers in conducting successful registered offerings and may lower their cost of capital.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Elai Katz at 212.701.3039 or ekatz@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Ross Sturman at 212.701.3831 or rsturman@cahill.com; or Paul Rafla at 212.701.3388 or prafla@cahill.com.

Release at 74.

¹⁵ *Adopting Release* at 19.

¹⁶ *Id.* at 14, 18-19.

¹⁷ *Id.* at 19, 105.

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