Towards the Deregulation of Offers: SEC Proposes Broad Exemption for Pre-Filing Communications

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SEC would significantly expand availability of JOBS Act TTW Provisions

Yesterday the Securities and Exchange Commission **proposed** a broad expansion of the popular "testing the waters" or "TTW" provisions to *all* companies, including seasoned reporting companies, smaller reporting companies and all pre-IPO companies, as well as business development companies (BDCs) and other registered investment companies. If adopted, new Rule 163B would allow all companies, and any person authorized to act on their behalf – including underwriters – to engage in oral or written communications with qualified institutional buyers (QIBs) and other institutional accredited investors (IAIs) prior to or after the filing of a registration statement in order to gauge investor interest in a registered offering.

Under the proposal, TTW communications would not be required to include any legend, nor would they be required to be filed with the SEC. Information in a TTW communication may not conflict with material information in the related registration statement, and would still be considered an "offer" under the Securities Act of 1933 and therefore subject to liability under the federal securities laws. In addition, Regulation FD would apply to TTW communications – in this regard, the fact that a company may be considering an offering is generally treated as material nonpublic information (MNPI).

This proposal represents a substantial expansion of the 2012 JOBS Act's accommodations currently available only to emerging growth companies (EGCs), and shows that the SEC has been carefully studying the impact of changes to the market introduced by that act. The proposal also represents a sure-footed step towards the full deregulation of offers under the federal securities laws while preserving important investor protections. The SEC is soliciting comments on the proposal until 60 days after its publication in the Federal Register.

Availability to underwriters

The ability of a non-EGC to test the waters for a registered offering is today constrained by the statutory requirement to have a registration statement on file that covers the securities being offered. Existing Rule 163 provides a limited exemption for well-known seasoned issuers (WKSIs), but the utility of this exemption is substantially diminished by the fact that it is not available to underwriters working on the transaction. The SEC **proposed** to eliminate this restriction in 2009, but never adopted a final rule.

Expanding the availability of "wall-crossing"

"Wall-crossing," or pre-marketing an offering on a confidential basis to a handful of investors prior to making a final decision to launch, has become a common and useful marketing tool for registered offerings in recent years, especially during periods of market volatility. For non-WKSIs without a registration statement on file, or for any company whose filed shelf registration statement does not happen to cover the particular securities being offered (sometimes the case with guaranteed securities or certain types of derivative securities), wall-crossing is generally unavailable for a registered offering. Proposed Rule 163B would level the playing field for these companies. If the proposed offering was itself considered material to the issuer, these companies would comply with Regulation FD the same way companies do today: by restricting the contacted investors from trading in the company's securities for a day or two, until the contemplated offering is publicly launched or abandoned (with consideration given to whether any cleansing announcement is needed if MNPI, which is not automatically cleansed upon abandonment of the deal, is conveyed to contacted investors).

Non-exclusivity

The proposal notes that Rule 163B would be non-exclusive and a company may rely on any other Securities Act rule or exemption, such as Rule 163, when communicating with potential investors prior to an offering. That said, we expect Rule 163B would in practice obviate the need for most companies to rely on any of the existing rules or exemptions when engaging in pre-deal communications.

Ability to flip to a private offering

Although the exemption provided by Rule 163B would cover communications in advance of a contemplated *registered* offering, and the rule would not be available for any communication that is part of a plan or scheme to evade the registration requirements of the Securities Act, the proposal does not appear to foreclose a company from deciding to conduct a private placement after using the rule to speak with investors in TTW meetings in what might have been a public offering. Indeed the non-exclusivity point discussed above suggests that reliance on Rule 163B should not foreclose a subsequent bona fide private placement. Presumably commenters will ask the SEC to confirm this when and if the rule is adopted.

No filing requirement

Although the proposal states that TTW communications are not required to be filed with the SEC and an exemption from free-writing prospectus filing is provided, the SEC staff often requests EGCs to submit any written TTW communications for staff review. Presumably commenters will also ask the SEC to clarify whether the staff intends to follow a similar practice with respect to non-EGCs that take advantage of Rule 163B.

Application to registered investment companies

The new rule would apply to registered investment companies, including BDCs. This is a welcome feature of the proposal, and notable because such companies have often generally been excluded from other worthwhile SEC reforms, such as **Securities Offering Reform** and several of the exemptions for broker-dealer research, without any easily understandable rationale. The SEC noted that though investment companies may be less likely to take advantage of communicating with potential investors prior to filing a registration statement, Rule 163B would allow them to communicate with QIBs and IAIs without complying with existing rules under the Securities Act and the Investment Company Act of 1940 requiring them to file, disclose and legend certain communications.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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