Easing the Prohibitions Against Gun-Jumping

Proposed SEC Rule Would Permit All Issuers to "Test the Waters" With Institutional Investors

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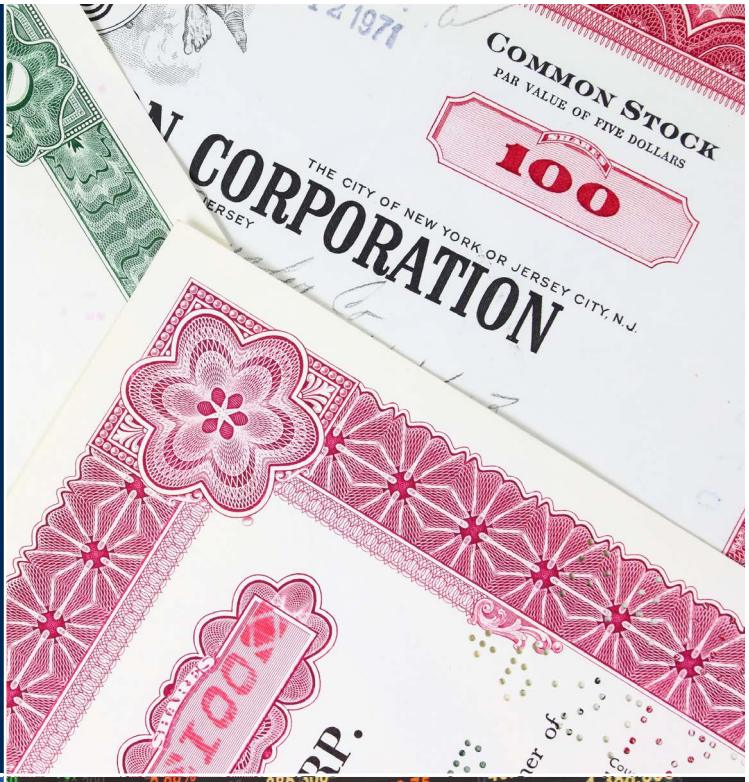

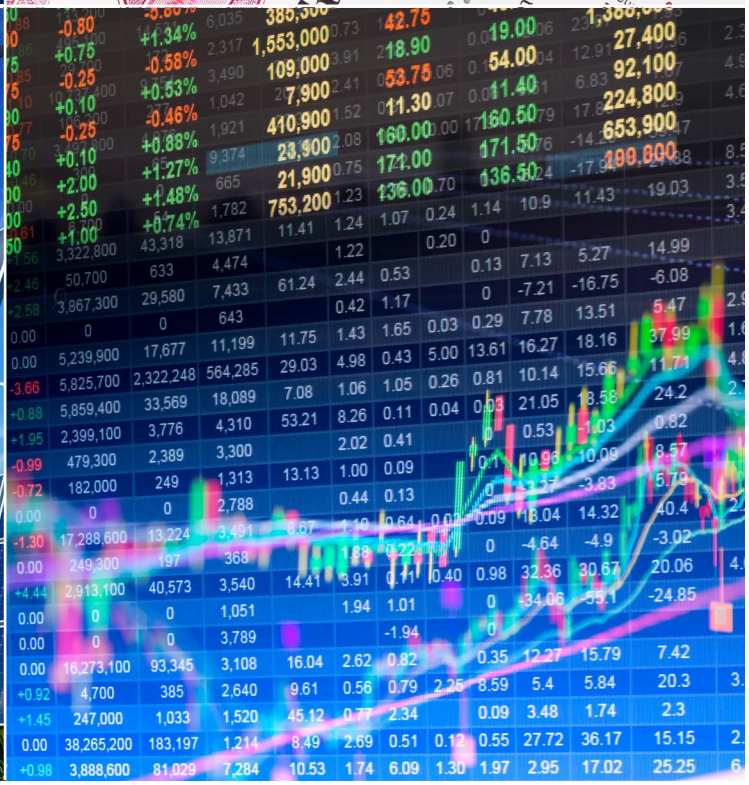

Takeaways

- Proposed Rule 163B would permit oral or written communications by all issuers with prospective investors that are QIBs or IAIs, prior to or after the filing of a registration statement, to gauge interest in a contemplated offering.

- Communications made pursuant to the proposed rule would not be required to be filed with the SEC or bear any legend.

- The proposed rule is intended to provide cost-effective means for evaluating market interest before incurring the costs of an offering.

Introduction

On February 19, 2019, the Securities and Exchange Commission (SEC) proposed a rule that would generally permit all issuers to "jump the gun"—that is, to make offers to certain institutional investors prior to the filing of a registration statement. This rule would enable any issuer, as well as its proposed underwriters, to "test the waters" to see to what extent these institutions might be interested in investing in the company before a registration statement is filed.

The Current Landscape

Under Section 5(c) of the Securities Act of 1933 (Act) it is generally unlawful to "jump the gun" by making an oral or written offer to sell a security before a registration statement is filed with the SEC.

Under Section 5(b)(1) of the Act it is generally unlawful to transmit a prospectus relating to a security with respect to which a registration statement has been filed with the SEC unless that prospectus meets the requirements of Section 10 of the Act.

Several existing rules under the Act, adopted from time to time over a period of decades, provide relief, subject to certain conditions and exceptions in each case, from the gun-jumping prohibitions of Sections 5(b)(1) and 5(c) of the Act, including:

- **Rule 134**, which permits limited information to be communicated after a registration statement has been filed, without such communication being deemed to constitute a "prospectus";

- **Rule 135**, which permits very limited information (but not, notably, the identity of any underwriters) contained in a notice published by or on behalf of an issuer or selling security holder of a proposed offering to be disseminated before a registration statement has been filed, without such notice being deemed to constitute an "offer";

- **Rule 163**, which exempts a well-known seasoned issuer (as defined in Rule 405 under the Act, a "WKSI") from the gun-jumping prohibitions of Section 5(c) of the Act; provided that any written communication that is an offer (as defined in Section 2(a)(3) of the Act) will constitute a free writing prospectus (as defined in Rule 405 under the Act, a "FWP") that must bear a specified legend and, subject to certain exceptions, be filed with the SEC;

- **Rule 163A**, which exempts from Section 5(c) of the Act certain communications made more than 30 days before the filing of a registration statement that do not refer to a securities offering that will be the subject of the registration statement;

- **Rule 164**, which provides that where the issuer is not an ineligible issuer (as defined in Rule 405 under the Act), an FWP used after the filing of a registration statement is deemed to be a Section 10(b) prospectus for purposes of Section 5(b)(1) of the Act;

- **Rules 168 and 169**, which permit the regular release of business information by specified issuers and/or to specified audiences, without such communications being deemed to constitute "offers"; and

- **Rule 255**, which permits testing-the-waters communications in offerings to be made under Regulation A under the Act.

The Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), among other things, amended Section 5 of the Act by adding a new subsection (d), which permits emerging growth companies (as defined in Section 2(a)(19) of the Act), or persons acting on their behalf, to engage in written or oral communications with prospective institutional investors to "test the waters"—to determine whether they might have an interest in a contemplated securities offering—prior to or after the filing of a registration statement with respect to that security, subject to the condition, among others, that such prospective investors are either qualified institutional buyers (as defined in Rule 144A under the Act, "QIBs") or institutional accredited investors (as defined in Rule 501(a) under the Act, "IAIs").

Proposed Rule 163B

Proposed Rule 163B would permit any issuer, and any person acting on behalf of an issuer (including an underwriter), to engage in oral or written communications with prospective investors, prior to or after the filing of a registration statement, to determine whether such investors might have an interest in the contemplated offering, subject to various conditions, including:

- such investors must be, or must be reasonably believed by the issuer to be, QIBs or IAIs; and

- the information contained in such communication cannot conflict with any material information contained in the related registration statement.

These "testing-the-waters" communications would not constitute "gun-jumping" because the rule would exempt them from Sections 5(b)(1) and 5(c) of the Act. However, these communications would nevertheless constitute "offers" and would be subject to Section 12(a)(2) of the Act and the anti-fraud provisions of the Act and the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

The proposed rule would expand the opportunities for permitted "wall-crossing" prior to filing a registration statement. Rule 163 under the Act currently permits WKSIs, or persons acting on their behalf, to make offers prior to filing a registration statement, with no limitations on the audience. This is available only to WKSIs, and the staff of the SEC has taken the position that it is not available to an underwriter even if the issuer has authorized the communication. The proposed rule would be available

to all issuers and persons acting on their behalf, expressly including underwriters, but, of course, would limit the audience to QIBs and IAIs.

Communications made pursuant to the proposed rule would not be required to be filed with the SEC or bear any legend.

In the proposing release, the SEC noted that:

- Rule 405 under the Act would be amended to exclude any such communication from the definition of a FWP;
- the SEC or its staff could require an issuer to provide copies of any such communication to the staff in connection with the review of a registration statement; and
- issuers subject to Regulation FD would have to consider whether any information in the communication would trigger any obligations under Regulation FD or whether any exception to Regulation FD would apply.

The proposing release requests comments on various specified aspects of the proposed rule. Comments are due within 60 days after the publication of the proposed rule in the Federal Register.

This note was prepared by J. Anthony Terrell as of February 26, 2019. At the time, Mr. Terrell was senior counsel in the New York office of an international law firm. He is now of counsel to Bracewell LLP, resident in the New York office. However, the views expressed herein are those of Mr. Terrell and do not necessarily reflect the views of the firm or any bar association of which Mr. Terrell is a member.