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Private Offerings After Testing-the-Waters

WRITTEN BY

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The SEC recently proposed allowing all issuers (not just emerging growth companies) to test-the-waters with qualified institutional investors (QIBs) and institutional accredited investors (IAIs) before and after filing a registration statement.[1] The commentary about this proposal has focused primarily on the ability to talk to investors without its being considered gun-jumping in violation of section 5 of the Securities Act. Missing from the discussion is whether an issuer that tests-the-waters is able thereafter to conduct a private offering in which general solicitation is not permitted.[2] Many issuers want to test-the-waters to figure out if their proposed financing plan makes sense for the public markets but do not want testing-the-waters to limit their ability to raise money privately. However, that can happen if the issuer does not take appropriate steps to avoid it.

The flexibility to do a private offering either to the investors with which the issuer tested-the-waters or other investors can be important because an issuer may learn as a result of its testing-the-waters that a public offering is either not feasible or not desirable or that one or more of the investors contacted about a possible public offering is more interested in investing privately. Therefore, to maximize the issuer's flexibility, it often is desirable to structure the test-the-waters activity so that there is no general solicitation.

Although the SEC does not appear to have addressed this question directly, our advice and prevailing market practice is that if the test-the-waters activity is properly structured an issuer can avoid its being a general solicitation. The key to avoiding a general solicitation is carefully selecting the investors with which the issuer will test-the-waters. If the test-the-waters activity does not involve a general solicitation, there should be no concern doing a subsequent private offering, either to the investors with which the waters were tested or other investors. However, even if the test-the-waters activity involved a general solicitation, an exempt private offering could still be done, either under Rule 506(c) or only with investors, which may include those contacted to test-the-waters, with whom there was a preexisting substantive relationship prior to commencement of the test-the-waters efforts that satisfied the criteria under the SEC's 2007 guidance.[3]

In the typical situation, it should be straightforward to structure the test-the-waters activity so that it does not involve a general solicitation because the targeted investors are, by definition, institutions and the issuer or its investment banker is likely to have a preexisting substantive relationship with them. The key to doing so is advance planning based on sound advice.

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[1] Release No. 33-10607 proposing to extend test-the-waters to all issuers may be found here: https://www.sec.gov/rules/proposed/2019/33-10607.pdf. See our blog post here discussing the proposal.

[2] An issuer in a private offering under §4(a)(2) of the Securities Act or Rule 506(b) may not engage in general solicitation. This is in contrast to Rule 506(c), which permits general solicitation if the purchasers are limited to

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verified accredited investors. There is still reluctance by some to rely on Rule 506(c) because of the verification requirement.

[3] Release No. 33-8828, pages 54-56, providing guidance on the ability to do a private offering during the pendency of a registered offering may be found here: https://www.sec.gov/rules/proposed/2007/33-8828.pdf. See also, SEC Compliance and Disclosure Interpretation §139.25.

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