Pay Up! (Are Issuers Shortchanging the SEC by Underpaying S-8 Registration Fees?)

B. Joseph Alley, Jr.

A quick survey of Forms S-8 filed in the last four years on the SEC's EDGAR system turns up something surprising—dozens of issuers appear to be underpaying the required registration fees for shares to be issued pursuant to employee benefit plans, shortchanging the SEC out of potentially millions of dollars. In fact, a large number of these issuers are even calling attention to their underpayments by citing as support for their fee calculations an SEC telephone interpretation that was withdrawn many years ago. These underpayments appear to stem in large part from issuers' and their counsels' misunderstanding of the current rules and interpretations that allow issuers to utilize the filing fees paid with respect to previously filed Forms S-8. In some instances, these rules and interpretations allow issuers to transfer and reuse fees paid for registering shares under predecessor plans that the issuer no longer expects to issue under those predecessor plans. Misunderstanding these rules and interpretations could result in something worse than a demand from the SEC that the full registration fee be paid—the Staff takes the position that failure to pay the full registration fee required for an offering results in the shares not having been registered on the registration statement. If this were the case, issuers would need to scramble to provide support for valid private placement exemptions for plan issuances and could be faced with the need to impose transfer restrictions on employees, file resale registration statements, or at worst, conduct rescission offers and "bust" resale trades.

Below, I summarize the current rules and interpretations, discuss what may be causing the confusion and provide suggestions of what issuers should and should not do in order to minimize the costs of registering new plan shares and to avoid the risk of underpaying employee benefit plan registration fees.

The Current Rules

Whether or not an issuer is currently able to transfer a filing fee from a previously filed Form S-8 is governed by Rule 457(p) under the Securities Act of 1933, as amended (the "Securities Act"), and SEC Staff Compliance Disclosure Interpretation ("CDI") 240.11. Note that even if an issuer is able to satisfy the requirements of the rule and the interpretation, it can merely offset the amount of the new fee by the amount of the carried-over fee. If the carried-over fee is not enough to offset the new fee, the balance must be paid. Issuers are not allowed to carry over shares in the sense that just because you previously registered the shares, that does not mean that you get a pass and do not have to calculate a new registration fee at the current, possibly higher, market price. Rule 457(p) provides that where all or a portion of the securities offered under a registration statement remain unsold after the offering's completion or termination, or withdrawal of the registration statement, the aggregate total dollar amount associated with those unsold securities may be offset against the total filing fee due for a subsequent registration statement filed within five years of the initial filing date of the earlier registration statement. What this actually means in the context of a Form S-8, and particularly a Form S-8 that registers shares to be issued upon the exercise of options, was addressed by the Staff in CDI 240.11, which states as follows:

> **Question 240.11**
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> **Question**: An issuer has a Form S-8 on file that registers shares of common stock to be issued upon the exercise of outstanding options. The issuer has decided to stop granting stock

options and believes that it has more shares registered on the Form S-8 than it will need to cover the exercise of the outstanding options. May the issuer transfer to a new registration statement the filing fees associated with the securities that the issuer believes it will not need to issue, and continue to use the Form S-8 to cover the exercise of the outstanding options?

Answer: No. Because Rule 457(p) permits filing fees to be transferred only after the registered offering has been completed or terminated or the registration statement has been withdrawn, the issuer may not transfer the fees associated with the securities that it believes it will not need to issue until the issuer completes or terminates the offering registered on Form S-8. [Jan. 26, 2009]

As I'll discuss below, this interpretation is much less favorable than previous, now withdrawn, telephone interpretations, but it's import is clear—if an issuer files a new Form S-8 registration statement for a new plan, it cannot transfer the portion of the registration fee that relates to unsold shares under a previous S-8, pursuant to a predecessor plan, if there are currently unexercised options outstanding under that predecessor plan. Because so many issuers do in fact issue options and option shares pursuant to their plans and register them on Forms S-8, and because options tend to have lengthy lives of 7 to 10 years, much of the issuer universe is prevented from utilizing any portion of the filing fees paid with respect to prior registration statements on Forms S-8 pursuant to Rule 457(p) and CDI 240.11. For example, if an issuer issues options on a Form S-8 with seven year lives, unless **all** of those options are exercised or forfeited early, there will always be an unexercised option outstanding long past the five year cut-off provided by Rule 457(p) and as a result, no unused fee could ever be carried forward from that registration statement.

What Went Wrong?

Why have so many issuers gotten this wrong? It's hard to know with certainty, and it may have a lot to do with the fact that having to pay a registration fee more than once for what the issuer views as the same shares is counterintuitive. The Securities Act, however, is interpreted to require the registration of each offer and sale, so that if a security is registered for offer and issuance pursuant to one plan, before it can be rolled into a new plan, it must again be registered for offer and issuance under that new plan, and a new fee must be paid, except to the extent that a previously paid fee can be carried over in accordance with Rule 457(p) and CDI 240.11. In addition, prior to the issuance of CDI 240.11 and the 2001 amendments to Rule 457(p) that provide for fee transfers, fee transfer provisions were contained in Rule 429, which addresses the use of one filed prospectus to cover the offer and sale of securities registered on more than one registration statement. Because Forms S-8 rarely contain filed prospectuses, however, they were ineligible to use the fee transfer provisions of Rule 429. In order to fill this gap, the Staff issued favorable telephone interpretations that were codified in writing in 1997 as Telephone Interpretations 89 and 90.[1] These interpretations allowed any fees related to unused shares from a Form S-8 to be transferred to a new Form S-8 for a new plan as long as the old Form S-8 is post-

1 89. Form S-8

Company A wishes to register a new employee benefit plan on Form S-8. Company A, however, wishes to use the filing fee paid on the remaining unsold shares of common stock that were registered under its old employee benefit plan on a previously filed Form S-8. While Rule 429 normally would be available for carrying forward a filing fee, it is unavailable for use with a Form S-8 since no prospectus is filed (see Release 33-6867). Instruction E to Form S-8, however, allows a company to increase the number of shares available under an existing plan. In this case, Company A should post-effectively amend the old Form S-8 to discuss the change in plans and file a new Form S-8 for the new plan with a note under instruction E stating the number of shares being carried forward from the old plan and the associated filing fee paid with the registration of those shares.

90. Form S-8

Company A has two employee benefit plans registered under two separate Forms S-8. Plan A applies to officers and directors and Plan B applies to salary and hourly employees. Company A wishes to remove the salary employees from Plan B and add them to Plan A. Plan A then would apply to officers, directors and salary employees, while Plan B would apply only to hourly employees. The number of shares originally registered for Plan A would be insufficient for the additional salary employees and the number of shares registered for Plan B would exceed the number needed of hourly employees. Company A wishes to move some of the shares from Plan B to Plan A. Company A should file a new Form S-8 under instruction E of S-8 for Plan A. That new Form S-8 should register at least one share, and in a footnote to the fee table Company A should disclose the number of shares it is moving from the Plan B Form S-8 and the previously paid filing fee associated with the registration of those shares. Company A also should file a post-effective amendment to the Plan B Form S-8 noting the removal of salary employees from Plan B and the number of shares moved to the newly filed Form S-8.

effectively amended to address the change in plans. It is these interpretations, which the Staff has informally confirmed have been withdrawn and are no longer applicable, that numerous issuers continue to mistakenly follow and to cite.

So What's the Big Deal?

So let's say you're one of these mistaken issuers—why should you care? Well, of course, there's always the concern of what actions the Staff might take if they think that you owe the SEC money, but as mentioned above, another real concern is the Staff's position that failure to pay the required registration fee means that the shares were not properly registered. Putting aside whether the Staff position could be successfully enforced, what happens to an issuer that issues employee benefit plan awards that it believes are registered but actually are not?

First, the issuer will need to find an exemption for the actual offer and issuance of each award. Integration issues and the concurrent conduct of a registered and private offering pursuant to the same employee benefit plan may present challenges to this analysis, but many issuers should be able to utilize a "stock bonus" position, basically claiming that registration is not required because the awards are given to employees without any consideration being given on the employee's part, and thus do not involve sales. This position is not available, however, in any situation in which the employee does provide consideration, such as execution of a non-compete agreement, for example. A full discussion of these issues is beyond the scope of this article, but a particular concern arises with respect to stock options. Although the Staff allows the issuance of shares upon exercise of employee options to be registered at any time prior to the exercise of the options, even if the issuance of the options themselves was not registered, it is possible that the privately issued options may have been exercised before the issuer can file a new Form S-8 registration statement to register any shares as to which the fee was not properly paid. In that event, the shares issued will need a registration exemption and will be subject to a holding period before they can be resold pursuant to Rule 144—generally six months for a reporting issuer. In addition, restricted stock units may present an issue depending upon the exemption used to award the units, as there is some question as to whether a holder may tack the holding period of the unit onto the holding period of the common stock received upon vesting of the unit. At any rate, a failure to adequately prove a valid exemption or to enforce required holding periods (which are generally not enforced by issuers who believe shares to be issued under a Form S-8 registration statement) may result in the need to conduct rescission offers and/or "bust" sales of the underlying stock into the public market, potentially at significant cost.

So What Should You Do?

Of course you should pay the SEC what you owe, and the SEC should collect all of these unpaid amounts, particularly in light of recent budget and staffing woes. On the other hand, we can always hope that the SEC Staff will soften its stance, withdraw CDI 240.11 and allow issuers to freely transfer unused shares from one Form S-8 to another, but until then, there are things you can do to minimize your risk and cost:

- First, when at all possible, amend and restate your existing plan rather than adopt a new plan—this should allow you to use general instruction E to Form S-8 and to simply register any new shares and continue to use any previously registered shares without the need to re-register or transfer fees;

- If you must adopt a new plan and need to transfer fees pursuant to Rule 457(p), do not commit the cardinal mistake of filing a post-effective amendment to de-register the old shares before you transfer the fees. In accordance with Staff guidance, if you de-register the shares before you have transferred the fees, you're out of luck and are not entitled to any fee transfer. Note that per the Staff, de-registering shares is not synonymous with completing or terminating an offering;

- Finally, don't wait until the last minute—if you plan ahead and give yourself sufficient time to evaluate your share needs and the expected timing of issuances, as well as to evaluate the application of Rule 457(p) and CDI 240.11 to your circumstances, you may be able to minimize the cost and avoid underpaying and making the mistakes outlined above.

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