



332 S. MICHIGAN AVE.  
CHICAGO, IL  
60604-4397

312 322 0200 <sup>PHONE</sup>  
312 322 0218 <sup>FAX</sup>  
WWW.LEXECON.COM

February 13, 2006

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
100 F Street, NE.  
Washington, DC 20549-9303

Re: File Number S7-10-05, Internet Availability of Proxy Materials, Proposed Rule

Dear Mr. Katz:

Lexecon is an economics consulting firm that specializes in the application of economics to legal and regulatory matters. Automatic Data Processing, Inc.'s ("ADP") Investor Communication Services division delivers over 95 percent of beneficial shareholders' proxy materials.<sup>1</sup>

ADP has asked Lexecon to analyze potential cost savings and increases from implementing the SEC's proposed rule, "Internet Availability of Proxy Materials." In particular, we analyze issues discussed in Section VI: Cost-Benefit Analysis of the proposed rule.

## **I. Introduction and Summary of Conclusions**

The SEC has indicated that it expects potential cost reductions in printing and mailing costs to be one of the most significant economic benefits of the proposed rule. The SEC has also indicated that average printing, paper, and postage costs are approximately \$5.95 for each mailed paper copy of proxy materials under the current system.

We understand that the \$5.95 estimate referenced by the SEC in the proposed rule was originally provided to the SEC by ADP several years ago using internal ADP information as well as information from the National Investor Relations Institute ("NIRI"). As we describe in more detail below, updating this estimate using similar sources leads to an estimate of the average total cost per mailed proxy under the current system of \$5.33.

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1. "ADP Investor Communication Services Story,"  
[http://ics.adp.com/release11/public\\_site/about/ics\\_story.html](http://ics.adp.com/release11/public_site/about/ics_story.html).

We analyze three factors that suggest that cost savings from the proposed rule are likely to be significantly smaller than \$5.33 per mailed proxy.<sup>2</sup>

- First, under the proposed rule, some shareholders will choose to print a copy of proxy materials themselves. The cost of printing at home is higher than the cost of professional bulk printing. These costs, which are transferred from issuers to shareholders, are part of the total cost to shareholders of the proposed rule.
- Second, under the proposed rule, some shareholders will request a printed copy of proxy materials. The cost of printing, processing, and mailing proxy materials to shareholders on demand is higher than under the current system.
- Third, \$5.33 represents an estimate of the total cost per mailed proxy of producing, printing, and mailing proxy materials, including the fixed costs of producing the annual report. However, the fixed cost of producing the annual report will still be paid under the proposed rule. The variable cost savings from reductions in printing and postage costs alone are significantly smaller than \$5.33 per mailed paper copy.

These factors represent permanent, annual cost increases to issuers and shareholders associated with implementing the proposed rule.

We use information from a survey of investors to develop a range of estimates for the percentage of shareholders that will print proxy materials at home and the percentage of shareholders that will request printed copies of proxy materials under the proposed rule. In particular, ADP has commissioned a survey of 1,500 individual investors by Forrester Research Inc., (“Forrester”) described in more detail in ADP’s comment on the proposed rule. Forrester surveyed shareholders regarding their likelihood of printing proxy materials at home and requesting a printed copy of proxy materials.

We also use information from ADP, NIRI, and other publicly available sources to develop estimates of printing, postage, and other costs for the current system as well as for the proposed rule. Our cost estimates for the proposed rule separate out the additional costs for shareholders who choose to print proxy materials at home and shareholders who request a printed copy of proxy materials.

Table 1 summarizes our results. More detailed information about how our estimates are constructed is presented in Sections II and III below.

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2. We do not analyze other factors that are also likely to lead to increased costs after implementing the proposed rule, including: (1) systems costs associated with providing online access to proxy materials; (2) costs associated with providing toll-free call centers to process shareholder requests; (3) one-time or transitional costs for issuers that opt-in to the new system; (4) additional costs borne by intermediaries; (5) costs resulting from a potential increase in the number of proxy contests; and (6) potential increases in voter solicitation costs.

**Table 1**  
**Cost Savings from Adoption of Proposed Rule**

		<b>Fraction of Shareholders Printing at Home, Requesting a Copy, or Viewing Materials Online</b>		
		<b>Scenario 1 Survey Responses</b>	<b>Scenario 2 58%</b>	<b>Scenario 3 38%</b>
Cost per Proxy Package: Current System	(1)	\$5.33	\$5.33	\$5.33
Cost per Proxy Package: Proposed Rule <sup>1</sup>	(2)	\$2.33	\$2.33	\$2.33
<i>Percent of Shareholders Printing at Home</i>	(3)	20.0%	13.5%	8.7%
<i>Cost to Print at Home</i>	(4)	\$7.95	\$7.95	\$7.95
Costs Transferred to Shareholders	(5)=(3)×(4)	\$1.59	\$1.08	\$0.69
<i>Percent of Shareholders Requesting Mailing</i>	(6)	38.7%	29.4%	18.7%
<i>Cost of Fulfilling Request for Mailing</i>	(7)	\$6.25	\$6.25	\$6.25
Additional Processing Costs	(8)=(6)×(7)	\$2.42	\$1.83	\$1.17
Total Cost per Proxy Package: Proposed Rule	(9)=(2)+(5)+(8)	\$6.33	\$5.24	\$4.19
<b>Cost Savings per Proxy Package</b>	<b>(10)=(1)-(9)</b>	<b>(\$1.01)</b>	<b>\$0.09</b>	<b>\$1.14</b>
Beneficial Proxy Records Mailed <sup>2</sup>	(11)	179,833,774	179,833,774	179,833,774
<b>Total Cost Savings<sup>3</sup></b>	<b>(12)=(10)×(11)</b>	<b>(\$181,064,897)</b>	<b>\$16,106,238</b>	<b>\$204,581,579</b>

1. Includes the fixed cost of producing the annual report and the fixed and variable costs of notice and access materials.
2. Based on ADP data for actual mailings in 2005.
3. Assumes 100% of issuers opt in to proposed rule.

We estimate that the average cost of producing, printing, and mailing a proxy package, which includes an annual report and a notice and proxy statement, is \$5.33 under the current system. Under the proposed rule, we estimate that the average cost per proxy package (*i.e.* per mailing of notice and access materials) will equal \$2.33, including the fixed costs of producing the annual report and the fixed and variable costs associated with producing, printing, and mailing the notice and access materials.<sup>3</sup> As a result, issuers will save an average of \$3.00 per proxy package in printing and postage costs compared to the current system, excluding the costs of printing at home and the costs of fulfilling requests for printed materials.<sup>4</sup>

3. Table 3 below shows that the fixed costs of producing the annual report accounts for the majority of the \$2.33 average cost per proxy package under the proposed rule. The fixed cost of producing the annual report must be spent regardless of the number or form of proxy packages that are mailed.
4. Note that we do not consider the costs of setting up and maintaining online delivery systems for proxy materials under the proposed rule.

We estimate that it will cost consumers an average of \$7.95 to print a 117 page proxy package (6.8¢/page) and that it will cost issuers an average of \$6.25 to send a printed copy of proxy materials to each shareholder that requests it.

There is substantial uncertainty about how shareholders will react if the proposed rule is enacted. We analyze three different scenarios regarding the percentage of shareholders that will print proxy materials at home and the percentage of shareholders that will request printed copies of proxy materials under the proposed rule.

Our first scenario is based on directly utilizing shareholders' responses in the Forrester survey regarding their likelihood of printing at home and requesting a printed copy of proxy materials. In particular, 20.0% of shareholders stated that it was likely that they would download and print out proxy information over the internet and 38.7% of shareholders stated that it was likely that they would request a printed copy of proxy materials be sent to them.

Utilizing additional information from the Forrester survey, we consider additional assumptions regarding the actions of survey respondents. In particular, Scenarios 2 and 3 assume that the total fraction of shareholders that will take an additional step to review proxy materials will equal either 58% or 38%. These scenarios lead to estimates of the percentage of shareholders that print at home of 13.5% in Scenario 2 and 8.7% in Scenario 3. Similarly, we estimate that the percentage of shareholders that will request a printed copy of proxy materials will equal 29.4% in Scenario 2 and 18.7% in Scenario 3.

Combining these assumptions, Table 1 shows that for every scenario, cost savings from implementing the proposed rule are significantly smaller than \$5.33 per mailed proxy package under the current system.

We estimate a range of possible impacts to costs from an increase in costs of \$1.01 to a savings of \$1.14 per mailed proxy under the current system. Had all issuers implemented the proposed rule during 2005, our estimates would lead to a range from an additional \$181 million in costs to a savings of \$205 million compared to the current system.

If enough shareholders request printed copies of proxy materials or print the materials themselves, the proposed rule actually costs more than the current system. Indeed, the proposed rule leads to cost savings precisely when enough shareholders are discouraged from participating in the process in this way.

The remainder of this letter provides additional details about the assumptions and calculations that lead to our estimates.

## II. Costs of Producing, Printing, Processing, and Mailing Proxy Materials

NIRI surveyed 278 companies in their August 2004 study, “Annual Reports: An Assessment of Trends and Practices in the Annual Report Process.” Table 2 uses information from the NIRI survey as well as data from ADP to estimate the average total cost per proxy package under the current system, including the cost for annual reports, proxy materials, and postage. The table splits the annual report costs into fixed and variable components.

**Table 2**  
**Total Cost per Proxy Package**  
**Current System**

Annual Report		
Fixed Costs <sup>1</sup>		
Online version	2%	\$0.08
Design	22%	\$0.86
Photography	8%	\$0.31
Illustrations	1%	\$0.04
Writing and Editing	6%	\$0.23
Typesetting	5%	\$0.20
Separations and Pre-Press	3%	\$0.12
Total Fixed Costs	47%	\$1.84
Variable Costs <sup>1</sup>		
Printing & Binding	41%	\$1.60
Paper	12%	\$0.47
Total Variable Costs	53%	\$2.07
Total Cost of Annual Report <sup>2</sup>	100%	\$3.91
Proxy Materials		
Fixed Costs <sup>3</sup>		\$0.10
Variable Costs <sup>4</sup>		\$0.37
Total Cost of Proxy Materials		\$0.47
Postage <sup>5</sup>		\$0.95
Total Cost of Proxy Package		\$5.33

Source:

<sup>1</sup> NIRI 2004 Annual Report Survey, Chart 20.

<sup>2</sup> NIRI 2004 Annual Report Survey, Chart 48.

<sup>3</sup> ADP estimate.

<sup>4</sup> ADP estimate. Includes \$0.30 printing and paper costs for a 44-page black and white document and \$0.065 for forms and other charges.

<sup>5</sup> ADP 2005 Proxy Season Key Statistics & Performance Ratings.

Table 3 estimates the cost of producing proxy materials under the proposed rule, using the breakdown between fixed and variable costs described in Table 2.

**Table 3**

**Total Cost per Proxy Package: Proposed Rule  
Excluding Costs of Printing at Home and  
Fulfilling Requests for Printed Materials**

Annual Report Fixed Costs <sup>1</sup>	\$1.84
Proxy Notification	
Fixed Cost <sup>2</sup>	\$0.10
Printing <sup>3</sup>	\$0.03
Postage <sup>4</sup>	\$0.36
Total Cost per Proxy Package	\$2.33

Source:

<sup>1</sup> NIRI 2004 Annual Report Survey, Charts 20 and 48.

<sup>2</sup> ADP estimate. Includes pre-press, typesetting, etc.

<sup>3</sup> ADP estimate of cost of printed duplex VIF card, forms, and other costs.

<sup>4</sup> ADP estimate. Assumes first class 1 oz. package after pre-sort.

Table 3 notes that the fixed cost of producing an annual report must still be paid under the proposed rule. As a result, variable cost savings from reductions in printing and postage costs under the proposed rule equal \$3.00 per proxy package, excluding the costs of printing at home and the costs of fulfilling requests for printed materials – significantly smaller than the \$5.33 cost of the current system.

Table 4 estimates the average additional cost that will be borne by shareholders that choose to print proxy materials at home. These costs are part of the total cost to shareholders of the proposed rule.

**Table 4**  
**Cost of Printing at Home**

Average Cost per Page	\$0.055
Black and White <sup>1</sup>	\$0.035
Color <sup>1</sup>	\$0.075
Percentage of Pages in Color	50%
Cost of Paper <sup>2</sup>	\$0.010
Cost per Page	\$0.065
5% Sales Tax	<u>\$0.003</u>
Total Cost per Page	\$0.068
Number of Pages <sup>3</sup>	117
Total Cost of Printing at Home	\$7.95

Source:

<sup>1</sup> Bernstein Research Call, "Dell, HPQ, and LXX: Assessing Cost of Ownership," June 24, 2005.

<sup>2</sup> Average of Office Depot, Office Max, Staples, and CompUSA prices for 500 sheet reams, January 2006.

<sup>3</sup> NIRI 2004 Annual Report Survey, Chart 49, and ADP estimate of 44 pages for proxy materials.

Table 4 shows an average cost of 6.8¢ per page for shareholders to print proxy materials home, assuming 50% of pages are printed on color printers with 15% color coverage.<sup>5</sup> With an average of 117 pages per proxy package, this leads to an additional cost to shareholders of \$7.95 per proxy package printed.

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5. Note that results would be similar if a smaller fraction of pages are printed in color with a greater percentage of color per page.

Table 5 presents estimates of the cost of fulfilling requests for printed copies of proxy materials on demand.

**Table 5**  
**Cost of Fulfilling Request for Mailing**

Printing and Paper	
Annual Report <sup>1</sup>	\$2.07
Proxy Materials <sup>2</sup>	\$0.37
Fulfillment <sup>2</sup>	\$1.50
Postage <sup>3</sup>	\$2.31
Total Cost per Mailing Request	<u>\$6.25</u>

Source:

<sup>1</sup> NIRI 2004 Annual Report Survey, Charts 20 and 48.

<sup>2</sup> ADP estimate.

<sup>3</sup> ADP estimate. Assumes 9 oz. first class flat with no pre-sort discount.

The calculations assume the same variable costs for printing as under the current system (Table 2). Fulfillment costs are based on ADP's estimate of the cost of responding to shareholder requests and sending materials on demand. Postage costs are based on ADP's estimate of the cost of sending materials using first class mail, without a pre-sort discount. Note that we do not include an extra component for costs associated with printing extra copies of proxy materials due to uncertain demand by shareholders at the time of printing. Summing the components leads to an estimate of \$6.25 per proxy package requested.

### **III. The Fraction of Shareholders That Will Print at Home or Request Printed Copies of Proxy Materials**

Under the proposed rule, shareholders can take one of four possible actions in response to the receipt of a notice and access card: (1) download and print the proxy materials at home; (2) request that a printed copy of the proxy materials be sent to them; (3) read the proxy materials online; or (4) do nothing. The first two choices lead to additional costs to issuers or shareholders while the latter two choices do not.

There is substantial uncertainty about the fraction of shareholders that will choose each option. We consider three different sets of estimates that span a range of outcomes. If better estimates become available, for instance from a pilot test of the proposed rule, we can update our results.

Forrester surveyed 1,500 individual investors regarding their likelihood of taking additional steps to review proxy materials. Forrester categorized 81.2% of the investors as online and 18.8% as offline, with little or no internet usage.



Forrester asked each investor whether they were likely or unlikely to undertake particular actions to review proxy materials. Table 6 provides the questions given to online and offline investors and their responses.

**Table 6**  
**Shareholders' Likely Responses to the Proposed Rule**

<i>Online Shareholders</i>			
Under the proposed new rule, you will have to take new or additional steps to get your annual reports and proxy voting information. Please state if you are likely or unlikely to do the following	Download and print out the information from the Internet	Likely	24.6%
		Unlikely	75.4%
	E-mail a request for information to be sent to you	Likely	36.2%
		Unlikely	63.8%
	Call the toll free number to request that information be sent to you	Likely	35.1%
		Unlikely	64.9%
	Go to the companies' websites and look at the information online	Likely	50.6%
		Unlikely	49.4%
	Do nothing	Likely	41.6%
		Unlikely	58.4%
<i>Offline Shareholders</i>			
Under the proposed new rule, you will have to take new or additional steps to get your annual reports and proxy voting information. Please state if you are likely or unlikely to do the following	Call a toll free number to request that paper copies be sent to you	Likely	51.9%
		Unlikely	48.1%
	Do nothing	Likely	40.1%
		Unlikely	59.9%

Source: Forrester 2006 Telephone Survey of Individual Investors

### *Scenario 1*

Our first scenario uses direct responses from the Forrester survey to estimate the fraction of shareholders that will print proxy materials at home or request that proxy materials be sent to them.

In particular, 24.6% of online shareholders state that they are likely to download and print proxy materials at home. Since no offline participants are likely to download and print at home, Scenario 1 assumes that, with 81.2% of shareholders online,  $81.2\% * 24.6\% = 20.0\%$  of all shareholders will print at home.

Similarly, 36.2% of online shareholders state that they are likely to request proxy materials via email and 35.1% via a toll free number. We assume that these are essentially the same shareholders and use an average of 35.6% as the fraction of online shareholders that are likely to request that proxy materials be sent to them. Taking a weighted average with the 51.9% of offline shareholders who state they are likely to request that materials be sent to them leads to an overall estimate of 38.7% for the percentage of all shareholders that are likely to request that proxy materials be sent to them.

*Scenarios 2 & 3*

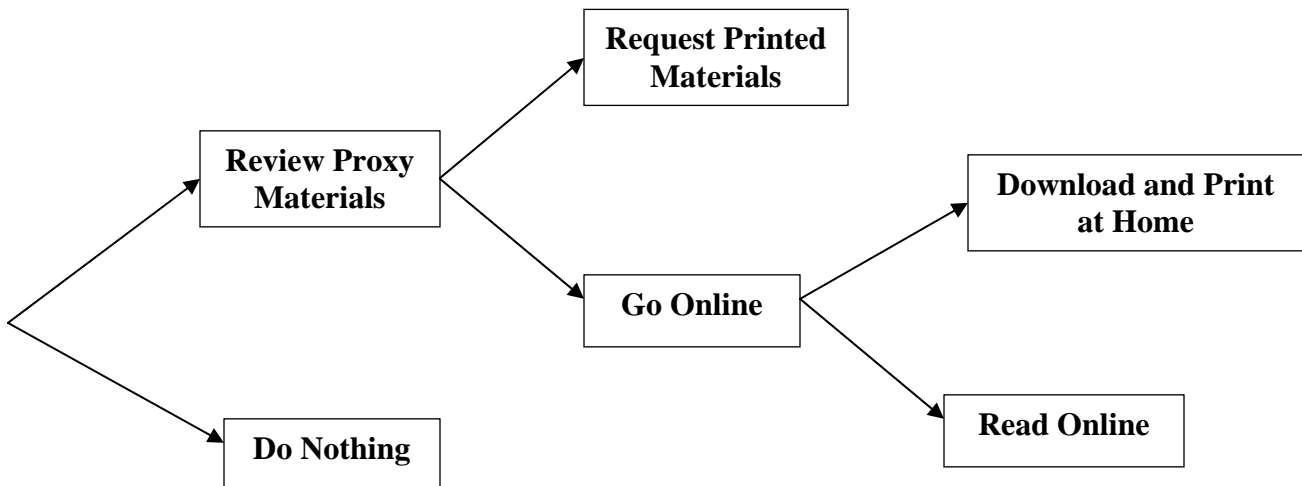
One problem with using shareholders’ direct survey responses as we do in Scenario 1 is that Forrester asked each question in Table 6 separately. Shareholders were not asked which of the four possible responses they are most likely to undertake, or what fraction of the time they are likely to undertake each option.

In particular, it is possible that some of the 35.6% of online shareholders who responded that they are likely to request a printed copy be sent to them also responded that they are likely to download and print materials at home. Indeed, the implied probabilities from Table 6 for the four possibilities sum to more than 100 percent.

As a result, we are forced to make assumptions about the interrelationships between shareholders’ answers to the questions in Table 6. Figure 1 describes the decision tree that we assume online shareholders follow in Scenarios 2 – 4.

**Figure 1**

**Online Shareholders**



The decision tree in Figure 1 implicitly allows us to draw conclusions about the interrelationships between a shareholder’s answers. For example, the decision tree implies that

none of the 42% of online shareholders that replied that they are likely to do nothing also replied that they are likely to review proxy materials in some other form.<sup>6</sup>

Scenarios 2 & 3 are based on different assumptions regarding the probability of the first branch in the tree, that shareholders will review proxy materials.

In Scenario 2, based on the answers in Table 6, we assume that 58.4% of online shareholders and 59.9% of offline shareholders will review proxy materials, either by requesting materials, printing at home, or reading online.

In Scenario 3, we make the assumption that 37.5% of shareholder will review proxy materials.<sup>7</sup> This is based on an alternative set of questions by Forrester, shown in Table 7, regarding how often shareholders think they will take extra steps to get proxy materials under the proposed rule.

**Table 7**  
**How Often Shareholders Will Take Extra Steps**

		Probability Shareholder Takes Extra Step	Fraction of Shareholders Taking Extra Step
Earlier you mentioned you automatically receive annual reports and proxy voting information. If the information was no longer automatically sent to you, but instead you had to take steps to get it, how often do you think you would take the extra step to get the information for each of your holdings?	All of the time	13.2%	100%
	Most of the time	17.0%	66.7%
	Some of the time	39.0%	33.3%
	None of the time	30.8%	0.0%
	Total	100.0%	37.5%

Source: Forrester 2006 Telephone Survey of Individual Investors

We make the assumption in Table 7 that “all of the time” corresponds to 100%, most of the time to 66.7%, some of the time to 33.3%, and none of the time to 0%. This leads to a composite

6. Note that if this assumption is false then a higher fraction of shareholders are likely to print at home or request that materials be sent to them.
7. The SEC notes in Section VI.C of their discussion of the proposed rule that 44% of accounts were voted by beneficial shareholders in 2005. The voting rate in 2005 is likely to differ from the fraction of shareholders that review proxy materials under the proposed rule for several reasons. First, some shareholders review proxy materials to become better informed about their stockholdings but do not vote. Second, under the proposed rule, some shareholders may be more likely to vote without taking the extra step to review proxy materials. Nevertheless, our assumptions in Scenarios 2 and 3 that 58.4% or 37.5% of shareholders will review proxy materials bracket the 44% voting rate in 2005.

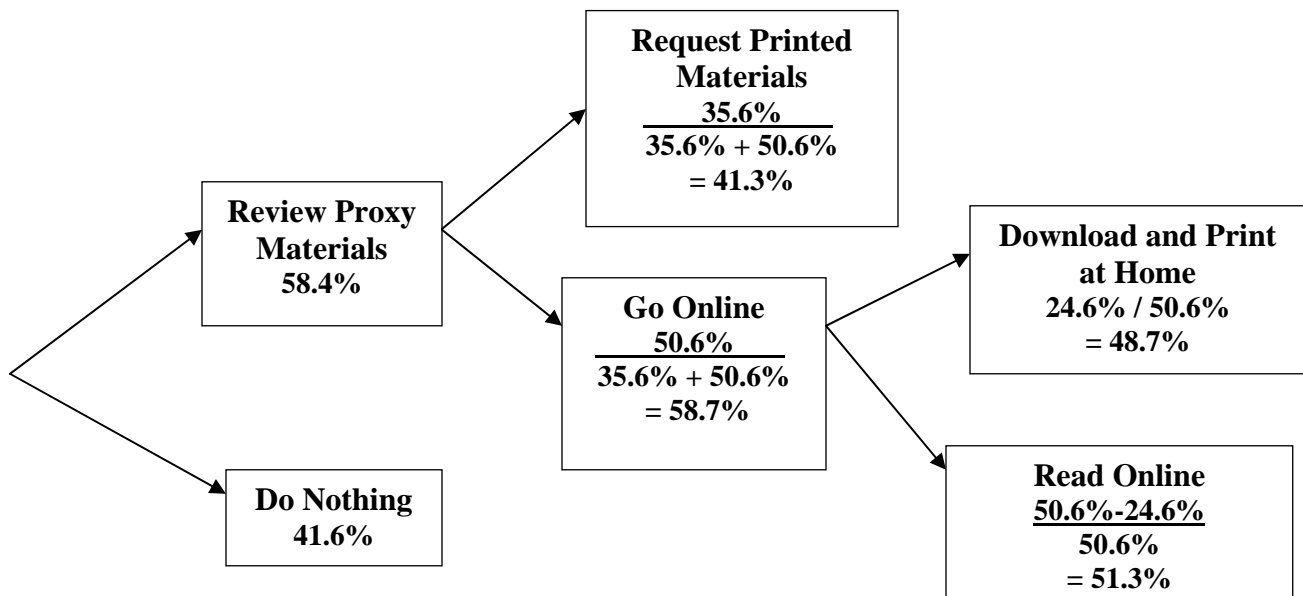
percentage of 37.5% of the time that shareholders are willing to take extra steps to review proxy materials.

We have just described how we estimate the fraction of shareholders that will choose the top versus bottom branches in the first step of the decision tree in Figure 1 for each scenario. We now discuss how we estimate the fraction of shareholders that will choose each subsequent branch of the tree. These conditional probabilities do not vary between Scenarios 2 & 3.

Figure 2 presents the calculations of the probabilities for online shareholders for Scenario 2. The calculations for Scenarios 3 are identical after changing the probabilities in the first branch.

**Figure 2**

**Online Shareholders: Scenario 2**



For the second branch, conditional on shareholders deciding to review materials, we assume that the fraction of shareholders that will request printed materials instead of going online is proportional to the fraction of shareholders that answered the corresponding question in Table 6 above. That is, since 35.6% of online shareholders said they are likely to request printed materials and 50.6% said they are likely to go to the companies' websites, we assume that  $35.6\% / (35.6\% + 50.6\%) = 41.3\%$  of the shareholders that review proxy materials will request printed materials. This is a version of the "logit" assumption that is commonly used in economic models of discrete choice.<sup>8</sup>

8. For more information, see for example, K. Train, *Discrete Choice Methods with Simulation*, Chapters 3-4, Cambridge University Press, 2003.

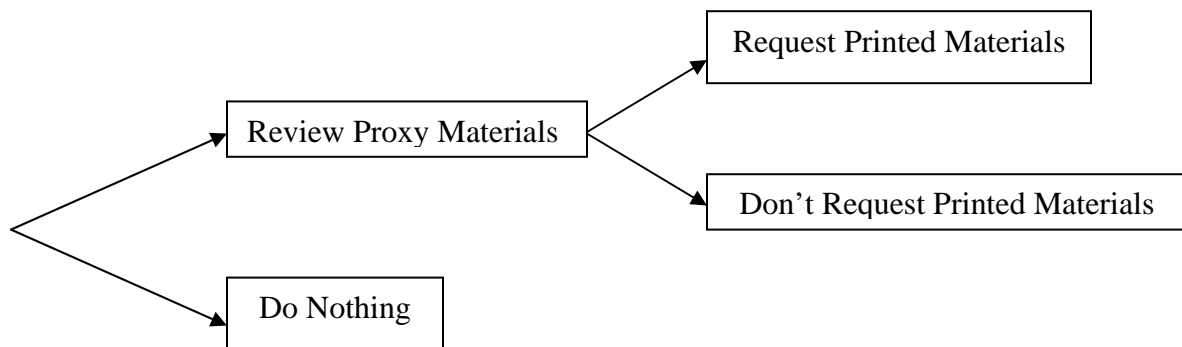
For the final branch of the tree we assume that all 24.6% of online shareholders who are likely to download and print information from the internet are among the 50.6% of shareholders that are likely to go to the companies' web sites to access proxy materials.

The final, unconditional probabilities can be calculated by multiplying the probabilities in each branch of the tree. For example, for online shareholders in Scenario 2, the fraction of all online shareholders that print at home equals  $58.4\% * 58.7\% * 48.7\% = 16.7\%$ . With 81.2% of shareholders online, this represents  $81.2\% * 16.7\% = 13.5\%$  of all shareholders.

The decision tree in Figure 1 applies to shareholders with online access. For the 18.8% of shareholders without online access, the decision tree, shown in Figure 3, is simpler.

**Figure 3**

**Offline Shareholders**



We vary the conditional probabilities in the first branch of Figure 3 across scenarios in the same way as we did for online shareholders. For Scenario 2, we assume that 59.9% of offline shareholders are willing to review proxy materials (see Table 6 above) and for Scenario 3, we assume that 37.5% will review materials (see Table 7 above).

For the second branch in the tree we assume that all 51.9% of offline shareholders who say they are likely to request that materials be sent to them come from the 59.9% of offline shareholders that say they are unlikely to do nothing to review proxy materials. Hence the conditional probability for requesting printed materials in the second branch of Figure 3 equals  $51.9\%/59.9\% = 86.7\%$ .

Table 8 presents our estimates of the percentage of shareholders that will print materials at home and the percentage that will request printed copies for online, offline, and all shareholders, under each scenario.

**Table 8**  
**Shareholder Response Rates**

		<b>Fraction of Shareholders Printing at Home, Requesting a Copy, or Viewing Materials Online</b>		
		<b>Scenario 1</b>	<b>Scenario 2</b>	<b>Scenario 3</b>
		<b>Survey Responses</b>	<b>58%</b>	<b>38%</b>
Percent Printing at Home	Online	24.6%	16.7%	10.7%
	Offline	0.0%	0.0%	0.0%
	All	20.0%	13.5%	8.7%
Percent Requesting Mailing	Online	35.6%	24.1%	15.5%
	Offline	51.9%	51.9%	32.5%
	All	38.7%	29.4%	18.7%

Note: 81.2% of shareholders are online and 18.8% of shareholders are offline.

The percentages in Table 8 for all shareholders are used in Table 1 to compute the effects of the proposed rule.

Sincerely,



David B. Gross  
Senior Vice President  
Lexecon