

fresh perspective and improve boardroom dynamics.²¹⁴

C. Potential Costs of the Proposed Rules

The proposed rules may impose additional direct costs. For purposes of the PRA, we estimate that the annual incremental burden to prepare the required disclosure would be approximately 1,828 hours of personnel time for operating companies, funds, and security holders, which translates into an estimated cost of \$155,400 (\$1,200 per company affected).²¹⁵ We also estimate a cost of approximately \$398,400 for the services of outside professionals (\$3,000 per company affected).²¹⁶

As we noted above, under the current rules, security holders generally can participate in the director nomination procedure only by recommending candidates to the nominating committee or by undertaking an election contest. As previously noted, commenters have found the first alternative to be largely ineffective and the latter to be too costly. Given the high costs associated with undertaking an election contest, many of the costs of the proposed rules to companies would be offset by the cost to security holders of undertaking an election contest.

For example, companies may incur additional printing and mailing costs if there is an increase in the number of security holder proposals seeking direct access that companies receive and must include in their proxy materials. Companies also may incur incremental printing and mailing costs to include the name and background information of security holder nominees in their proxy materials. In 1998, when the Commission last sought comment on a proxy rule amendment, companies reported that the average cost of printing and mailing security holder proposals was approximately \$50,000.²¹⁷ In response to our May 2003 request for public input, one commenter noted that

increasing the weight of a company's proxy materials by two ounces could increase the cost of mailing 100,000 packages by \$308,825.²¹⁸ The additional incremental printing and mailing costs would vary based on the number of security holder proposals that are required to be included in a company's proxy materials, the number of security holder nominees that are required to be included in company proxy materials and the size and weight of a company's existing proxy statement.

The additional incremental cost of printing and mailing security holder proposals seeking direct access and including security holder or security holder nominees in the company's proxy material would likely represent costs that would otherwise be borne by security holders to print and mail their own complete proxy statement when a security holder undertakes an election contest.

There also may be increased costs associated with additional solicitations by both companies and security holders. Companies may increase solicitations to vote against security holder proposals or to vote for their slate of directors. Security holders may also increase solicitations to vote for security holder proposals or to withhold votes for a company's directors. Similarly, companies may also increase their costs for solicitations if security holders or security holder groups undertake election contests. For the purposes of the PRA, we estimate that the proposed Exchange Act Rule 14a-11 nomination procedure would occur in 41 incidences for operating companies and 9 incidences for funds.

There also may be a cost if the proposed rules serve to influence corporate behavior. Commenters argued that there is no evidence that security holder access would lead to better managed companies.²¹⁹ To the extent that there is a change in corporate behavior, companies may incur additional costs in instituting more responsive policies and procedures to address security holder concerns. Commenters also were concerned that the time a company spends on its security holder relations could lessen the time that boards would have to engage in strategic and long-term thinking.²²⁰ Such a decrease in the time spent by a board on overseeing the management of a company may

negatively affect the value of security holders' investments.

In those cases where proposed Exchange Act Rule 14a-11 would be triggered, commenters also were concerned that security holder access may discourage qualified board members from running.²²¹ If a security holder nominee is elected, commenters were further concerned that the security holder-nominated director may disrupt boardroom dynamics and polarize the board.²²² In particular, commenters expressed concern that the security holder access rule could be used by special interest groups who have interests that are different from security holders generally.²²³ Any potential degradation in the quality of the individuals on the board may decrease the value of security holder investments.

D. Small Business Issuers

Although the proposed rules apply to small business issuers, we do not anticipate any significant impact on them. Small businesses historically have received fewer security holder proposals than larger issuers.²²⁴ Further, the number of security holder proposals that generally receive a majority vote, the number of directors that receive 35% "withhold" votes, and the percentage of nominating security holders that meet the ownership threshold and holding periods may be lower for small business issuers than other issuers since insiders generally hold a large percentage of shares in small businesses.²²⁵ While we recognize that issues of corporate accountability and security holder rights may affect small companies as much as they affect large companies, we have included a specific request for comment regarding

²²¹ See *id.*

²²² See *id.*

²²³ See *id.* Although the proposed rules address the issue of special interest directors by requiring that the nominating security holder be independent from the security holder nominee, there still may be concern that the security holder nominee is informally beholden to the nominating security holder.

²²⁴ Of the 266 companies that submitted letters to the Division of Corporation Finance during the 2002-2003 proxy season regarding their intentions to exclude a security holder proposal submitted under Exchange Rule 14a-8, only 26 had a common equity public float of less than the \$75 million threshold in the definition of "accelerated filer." Accordingly, the number of small businesses issuers would be even less than that figure.

²²⁵ See James S. Ang, Rebel A. Cole, & James Wuh Lin, *Agency Costs and Ownership Structure*, *The Journal of Finance*, Volume LV No 1, 81, 96 (February 2000). Based on a sample size of 1,708 small companies, defined as companies with \$6 million in sales, on average, 73% of these companies had one family that owned 50% or more of the company.

²¹⁴ See 2003 Summary of Comments.

²¹⁵ We estimate the average hourly cost of in-house personnel to be \$85. This cost estimate is based on data obtained from *The SIA Report on Management and Professional Earnings in The Securities Industry* (Oct 2001).

²¹⁶ The cost may vary from company to company. The total dollar costs have been prorated across all companies, funds and security holders affected. We estimate that 111 operating companies and 24 funds will be impacted by some aspect of the proposed rules. These figures differ slightly from the PRA figures reflected in the Calculation of Incremental PRA Burden Estimates table because they do not reflect the number of funds affected by the removal of Item 77C from Form N-SAR and the transfer of the burden of 1405 hours associated with Item 77C to Form N-CSR. This transfer does not result in any net new costs to funds.

²¹⁷ See Release No 34-40018 (May 21, 1998) [63 FR 29106].

²¹⁸ See 2003 Summary of Comments. The response may have accounted for the printing of more than one proposal.

²¹⁹ See *id.*

²²⁰ See *id.*