

# Can Lax Corporate Law Increase Shareholder Value? Evidence from Nevada

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## Abstract

Recent scholarship argues that Nevada's lax corporate law, which exempts managers from fiduciary duties as well as discourages takeovers, may harm shareholder wealth. I present comprehensive evidence that Nevada corporate law does not harm shareholder value for firms that self-select into Nevada, particularly small firms with low institutional shareholding and high insider ownership, and it may in fact enhance the value of these firms. A possible explanation is that Nevada's pro-managerial laws reduce the likelihood of takeovers and litigation, thereby benefiting a segment of small firms for which the costs of corporate governance may outweigh the benefits.

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## 1 Introduction

In recent years, Nevada has emerged as a popular state of incorporation for many firms, especially small firms with few institutional shareholders and relatively high inside ownership (Barzuza & Smith, 2014; Eldar & Magnolfi, 2016). In the US, the laws of the state of incorporation determine corporate governance on matters such as takeover defenses and the fiduciary duties of directors and officers. Nevada offers laws that are more protective of managers than many other states, particularly Delaware, which is home to more than 60% of firms in the US. Nevada not only offers a broad array of anti-takeover statutes,<sup>1</sup> but also extends expansive liability protection to managers of Nevada firms.<sup>2</sup> The migration of firms to Nevada seems to be driven by its lax corporate law with respect to managers, particularly a 2001 law reform which exempted managers from liability for violation of the duty of loyalty without requiring shareholder approval (Barzuza & Smith, 2014; Eldar & Magnolfi, 2016). This might suggest that choices of corporate governance laws, at least by small firms, are driven by managers' desire to shield themselves from liability to the detriment of shareholders; recently, Barzuza & Smith (2014) have shown that firms that incorporate in Nevada have a higher rate of financial restatements, and suggest that such restatements may decrease shareholder value.<sup>3</sup>

However, the evidence of financial misreporting does not necessarily mean that Nevada law harms shareholder value. In fact, if Nevada firms are more fragile as indicated by their higher restatement rate, their choice to incorporate in Nevada may actually make economic sense. Firms may incorporate in Nevada to lower the costs of corporate governance by reducing the probability of hostile takeovers and litigation. On this view, the decision to adopt laws exempting managers from liability may actually be a value enhancing decision to invest fewer resources in monitoring managers and reduce the costs of litigation (Kobayashi & Ribstein, 2012). Several proxy statements of firms reincorporating into Nevada expressly

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<sup>1</sup>Nevada corporate law has several anti-takeover statutes, including (i) a statute that protects poison pills from judicial review (Nev. Rev. Stat. Ann. § 78.138), and (ii) a statute that imposes business judgment deference to anti-takeover defenses and rejects Delaware's proportionality standard of review (Nev. Rev. Stat. Ann. § 78.139(2)).

<sup>2</sup>Under Nevada corporate law, unless the charter otherwise provides otherwise, directors and officers are not individually liable to the corporation or its stockholders or creditors for any damages unless it is proven not only that the director or officer breached a fiduciary duty to the corporation, but also that such breach involved intentional misconduct, fraud or a knowing violation of law (Nev. Rev. Stat. Ann. § 78.138(7)).

<sup>3</sup>As argued by Barzuza & Smith (2014), "To the extent that holding equity in a firm likely to restate financials increases the chance of experiencing...losses, Nevada firms can impose costs on the investors interested in holding their equity." See also Barzuza (2012).

state that one motivating factor is to reduce the risk of lawsuits being filed against the company's managers in exercising their duties.<sup>4</sup> Similarly, a decision to incorporate in a state that allows greater freedom for managers to prevent hostile takeovers may help firms' managers to focus on long-term growth and building the firms' business (Johnson et al., 2015).<sup>5</sup>

Moreover, there seems to be no convincing evidence that Nevada incorporation adversely affects share prices. First, while incorporation in Delaware has been historically associated with higher Tobin's Q measure (Daines, 2001), a recent study actually finds that Nevada firms have higher Tobin's Q than firms incorporated elsewhere, including in Delaware (Litvak, 2013). These findings arguably suggest that not only are Nevada laws not harmful, but they may potentially be conducive to shareholder value. Second, there is as yet no event study showing that there are any stock price effects associated with firms reincorporating into Nevada. An event study of one firm by Kobayashi & Ribstein (2012) suggests that reincorporation into Nevada does not affect abnormal returns in any material way. Finally, the most controversial element of Nevada law is arguably the 2001 law reform which exempted directors and officers from liability for the duty of loyalty. One recent study suggests that this law harmed shareholder value (Donelson & Yust, 2014). But, as explained below, this study is based on limited data, a mistaken legal analysis of the effect of the 2001 law reform on Nevada firms, and suffers from other methodological problems.

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<sup>4</sup>For example, the proxy statement of Warrantech which reincorporated from Delaware to Nevada in 2005 states that the reincorporation "...may reduce the likelihood of frivolous lawsuits being filed against the Company and its directors and officers... It is the Company's desire to reduce these risks to its directors and officers, and to limit situations in which monetary damages can be recovered against directors, so that the Company may continue to attract and retain qualified directors who otherwise might be unwilling to serve because of the risks involved."; see [https://www.sec.gov/Archives/edgar/data/735571/000101905604001471/warran\\_def14a.txt](https://www.sec.gov/Archives/edgar/data/735571/000101905604001471/warran_def14a.txt). Another example is the recent reincorporation of Cleantech Solutions International Inc. in 2012 from Delaware to Nevada. Its 2012 proxy statement expressly says: "reincorporation in Nevada may help us attract and retain qualified management by reducing the risk of lawsuits being filed against the Company and its directors... We believe that...Nevada law provides greater protection to our directors and the Company than Delaware law." See [https://www.sec.gov/Archives/edgar/data/819926/000121390012002971/def14a0512\\_cleantech.htm](https://www.sec.gov/Archives/edgar/data/819926/000121390012002971/def14a0512_cleantech.htm).

<sup>5</sup>The proxy statement of Warrantech in 2005 also states: "In responding to an unsolicited bidder, Nevada law also authorizes directors to consider not only the interests of stockholders, but also the interests of employees, suppliers, creditors, customers, the economy of the state and nation, the interests of the community and society in general, and the long-term as well as short-term interests of the corporation and its stockholders, including the possibility that these interests may be best served by the continued independence of the corporation... The Board believes that unsolicited takeover attempts may be unfair or disadvantageous to the Company and its shareholders..." Another example, the 2004 proxy statement of Octus Inc. that proposes the reincorporation from California to Nevada "These [Nevada] laws include provisions that, in the judgment of the Company's Board of Directors, will allow the Company to better protect the interests of its shareholders in situations involving a potential change in corporate control." See <https://www.sec.gov/Archives/edgar/data/891462/000108638001500097/octus14cdef01.txt>.

The main goal of this article is to conduct a comprehensive study of the relationship between Nevada law and shareholder value. From a policy perspective, the question of whether Nevada corporate law adversely affects shareholder value is of particular importance to the general debate over the need for national corporate laws. If Nevada's lax laws were a vehicle for managerial rent extraction at the expense of shareholder value, then there would be scope for the federal government to intervene by enacting mandatory standards for states' corporate laws. For example, a federal law might be passed that prevents firms from exempting managers from the duty of loyalty or at least requires shareholder approval for such an exemption to be effective. On the other hand, if Nevada law benefits or does not harm shareholder value, there is little need for federal intervention to protect shareholders.

The findings of this study show that Nevada law does not adversely affect the value of Nevada firms, and may in fact enhance it. First, I find that Nevada corporate law is associated with higher Tobin's Q for a subset of small firms that choose to incorporate in Nevada. I show that although both Delaware and Nevada firms have higher Tobin's Q than firms incorporated elsewhere, the "Nevada effect" persists only for the small firms in the sample. I also run a Tobin's Q regression with matching estimators where the treatment effect is Nevada incorporation. Using matching estimators helps address concerns that Tobin's Q is measured with error for small firms with few tangible assets. The results show that while the average effect of Nevada law for all firms is either zero or negative, the average treatment effect on the treated, i.e., the effect of Nevada law on those firms that self-selected into Nevada, is positive. Thus, the results support the hypothesis that firms' choice of Nevada law is conducive to their shareholder value.

Second, I conduct an event study of firm reincorporations into Nevada for the years 1996-2013. Because most firms that reincorporate into Nevada tend to be small and thinly traded, it is a challenge to estimate the abnormal returns associated with their reincorporations. Using a model developed by Maynes & Rumsey (1993) to compute the cumulative abnormal returns for thinly traded stocks, I show that Nevada reincorporations are associated with positive cumulative abnormal returns, though for many specifications, the results are not statistically significant. These results hold even when we consider (a) firms that immigrate from states offering lower liability protections for directors and managers (meaning that their reincorporations increase the protection afforded to managers from liability), and (b) firms with a relatively larger percentage of insider ownership, where managers have greater power to act opportunistically at the expense of other shareholders.

Third, I test the hypothesis that Nevada director and officer liability laws harm shareholders by conducting an event study of the passage of the 2001 Nevada corporate law reform that arguably accounts for Nevada's laxity towards managerial liability. If such laws give strong incentives for managers to extract rents from companies, then one would expect the stock prices of Nevada firms to drop around the time that such laws were passed. However, using a sample of 106 firms for which there is data on share prices on CRSP, I show evidence that the 2001 law reform had no negative effect on the shareholder value of Nevada firms.

Taken together, the Tobin's Q regressions and the event studies support the hypothesis that Nevada's protectionist laws do not harm shareholder value and may in fact increase it for a subset of small firms that choose to incorporate in Nevada. As mentioned above, one explanation might be that Nevada law reduces the costs of corporate governance and shareholder monitoring for small public firms. To evaluate whether Nevada law has this impact, I conduct two related tests. First, I measure the extent to which the probability of being acquired is related to Nevada incorporations. Prior research shows that Delaware incorporation is correlated with a higher probability of being acquired (Daines, 2001). My study finds the opposite results for Nevada. I further show that Nevada firms are not necessarily less likely to receive bids than Delaware firms, but rather that bids for Nevada firms are more likely to fail. Second, I present evidence suggesting that incorporation in Nevada is associated with a lower risk of litigation than in Delaware. Thus, firms' migration to Nevada seems to be at least partly due to the lower risk of takeovers and lawsuits associated with Nevada incorporation. In this respect, I emphasize that the ability to defend against takeover bids is related to the risk of litigation. Most takeovers in recent years have been followed by shareholder lawsuits, where shareholders sue managers for failure to obtain a higher price for their shares. (Romano, 1990; Krishnan et al., 2012; Cain & Davidoff, 2014).

Before embarking on the analysis, I emphasize that evidence that Nevada law may enhance shareholder value does not mean that Nevada law is value enhancing for every firm. As discussed below, there is a large body of literature, including Tobin's Q regressions and event studies, showing that Delaware law is associated with higher firm value. In contrast to Nevada law, Delaware law is more takeover-friendly and does not permit firms to exempt managers from the duty of loyalty. However, while Delaware and Nevada present two different systems of corporate governance laws, the view that Delaware law enhances shareholder value is not inconsistent with the view that Nevada law benefits shareholders of firms who self-select into Nevada. This is because the firms that incorporate in Nevada are different

from those that incorporate in Delaware - as discussed below, they tend to be significantly smaller, have a lower percentage of institutional shareholdings and a higher percentage of insider ownership than Delaware firms. These firms may wish to avoid Delaware's litigious and takeover-friendly environment by incorporating in a more protectionist state. For those firms, Nevada law may indeed best serve the interests of shareholders.

This article proceeds as follows. Section 2 discusses the existing literature. Section 3 analyzes the performance of Nevada firms measured by Tobin's Q, using not only standard pooled regressions, but also matching estimators. Section 4 examines the stock price effect of firm reincorporation into Nevada. Section 5 conducts an event study of the 2001 law reform that exempted the managers of Nevada corporations from liability for violating the duty of loyalty. Section 6 examines the channel through which Nevada incorporations affects shareholder value by presenting evidence that Nevada incorporation is associated with a lower probability of takeover and litigation. Section 7 concludes.

## 2 Related Literature and Hypothesis Development

Studies of the effect of corporate laws on shareholder value have generally been divided into three types: (a) Tobin's Q regressions on firms' state of incorporation over time, (b) event studies of reincorporation decisions, and (c) studies of the effect of a change in corporate laws. As discussed below, each of these techniques suffers from one or more methodological problems, and neither the finance nor the legal literature has offered a clear-cut way to address these problems. By taking a comprehensive approach, I mitigate concerns that potential shortcomings of one method might generate results that do not hold under a different approach.

Since Daines (2001), it has become common practice to regress Tobin's Q on states of incorporation with a variety of controls, such as the firm's leverage and size. The classic result is that incorporation in Delaware is associated with higher Tobin's Q for public firms. Although this result was challenged by Subramanian (2004), it was replicated by Litvak (2013) and Barzuza & Smith (2014).<sup>6</sup>

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<sup>6</sup>More recently, Cremers & Sepe (2014) have argued that corporate laws that favor managers increase firms' Tobin's Q. However, their sample of firms seems to be at odds with the sample in Barzuza (2014), Litvak (2013) and my sample because (a) it does not reportedly include a significant share of Nevada incorporations, and (b) it appears to rely mainly on a large number of reincorporations of financial firms into Maryland. It is well known that financial firms incorporate in Maryland mainly because its corporate law code allows for greater flexibility in governance for registered investment funds, and hence is particularly attractive to mutual funds and investment firms (Langbein,

Tobin’s Q studies, however, suffer from endogeneity and selection bias (Listokin, 2008; Litvak, 2013), and methods to address this issue tend to be imperfect. First, there seem to be no good instruments for the state of incorporation. Instruments based on geographical location are unlikely to satisfy the exclusion restriction, which in this context, requires that location only affects share value through the state of incorporation (Litvak, 2013). Second, models that control for firm fixed effects arguably identify the effect of reincorporation into a new state, but the number of reincorporations into states other than Delaware is relatively small; therefore, such identification is weak. Moreover, reincorporations themselves may be endogenous and driven by unobserved factors.<sup>7</sup> Third, restricting the sample to mature firms that do not experience any reincorporation in the relevant period may mitigate endogeneity (Daines, 2001), but only imperfectly. The state of incorporation could arguably be viewed as exogenous for mature firms because these firms presumably have not considered making a shift to another state. But, old incorporation decisions may be correlated with current unobserved variables (Listokin, 2008). Moreover, mature firms may have different characteristics than less mature ones. Although the results in this article are generally robust in a sample of mature firms, the number of Nevada firms in this sample is disproportionately lower as compared to Delaware firms, seemingly because many Nevada firms are small and presumably tend to go private after a few years. Accordingly, results in Tobin’s Q regressions need to be treated with caution, and in themselves may be insufficient for evaluating the effect of a state’s laws on shareholders value.

Another problem with Tobin’s Q regressions is that they may be inadequate for assessing the performance of small firms with few tangible assets. The Tobin’s Q measure is essentially market value divided by total assets, and thus when the assets are worth near \$0, the Tobin’s Q measure spikes (Subramanian, 2004).<sup>8</sup> As stated above, Litvak (2013) recently showed that Nevada firms have higher Tobin’s Q than firms incorporated in other states.<sup>9</sup> However,

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1997). Cremers & Sepe (2014) also argue that Delaware’s law adversely affects the performance of firms after the IPO stage, but it is a well-known phenomenon that the long-run performance of IPO firms tends to be weak (Ritter & Welch, 2002).

<sup>7</sup>For example, reincorporation into Delaware often occurs in the context of a merger or an expectation of receiving a bid (Romano, 1985). This might drive the market value of the firm upward prior to the reincorporation.

<sup>8</sup>Interestingly, Subramanian (2004) argues that the positive correlation between Delaware incorporation and Tobin’s Q in a sample of firms in the period between 1991 and 2002 is driven by small firms. Similarly, in my sample of firms in the period 1994-2013, I find that the “Nevada effect” is due to small firms. But contrary to Subramanian (2004), I find that Delaware incorporation is associated with higher Tobin’s Q even when the sample is restricted to large firms.

<sup>9</sup>Unlike Litvak (2013) and this study, Barzuza & Smith (2014) find no statistically significant association between Nevada incorporations and Tobin’s Q, although the validity of their results is somewhat questionable because their

since Nevada firms tend to be small and have few tangible assets, there is a concern that most of the “Nevada effect” is attributable to this measurement problem of Tobin’s Q with respect to small firms. I use matching estimators to address this problem, a strategy not employed in past studies. Linear regressions may be inappropriate to adequately control for size, because the distribution of firm size among firms that incorporate in Nevada is heavily skewed towards smaller firms. In this case, a linear regression is likely to rely heavily on extrapolation, and thus will be sensitive to the exact functional form (Imbens & Rubins, 2015). Matching estimators that directly compare the Tobin’s Q score of Nevada firms to that of other firms with similar characteristics (such as size, ownership structure or industry) provide a more reliable method for evaluating the correlation of Nevada incorporation and Tobin’s Q. Another important advantage is that they allow examination of the average treatment effect on the treated, i.e., the firms that have self-selected into Nevada law. In this respect, I emphasize that the critical question is not whether Nevada law is universally beneficial for all firms (including those that incorporate elsewhere), but rather whether it improves the value of firms that choose to incorporate under it. In fact, subject to the problem of selection bias, I find that the average treatment effect of Nevada law for all firms is either zero or negative, but the average treatment effect on the treated is positive.

A more direct way of examining the effect of incorporation on firm value involves event studies of firms’ reincorporations events (see Bhagat & Romano, 2002). This article presents the first event study of firm reincorporation into Nevada. All studies of firm reincorporation to date have focused on Delaware. These studies show that reincorporation in Delaware is associated with a positive price effect (Dodd and Leftwich, 1980; Romano, 1985; Peterson, 1988; Netter and Poulsen, 1989; Heron and Lewellen, 1998). While these studies do not show the benefits of incorporating into specific states over time, they directly analyze how investors view reincorporations at the time when these decisions are made. The advantage of this method is that it directly tests the effect of firm reincorporation on the firms that choose to incorporate in the relevant state. This is particularly important in the case of Nevada because of the concern that firms reincorporate into Nevada in order to exploit its liability exemptions (Barzuza, 2012; Barzuza & Smith (2014)). If reincorporation is associated with higher cumulative abnormal returns, then presumably giving firms the choice to choose their

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model fails to include year and industry dummies and standard controls, such as spending on research and development. Moreover, they seem to omit from their sample firms with no data on CRSP and those not traded on major exchanges; thus, their sample is seemingly biased towards larger firms. However, as I show below, Nevada law seems to actually benefit smaller firms that self-select into Nevada.



state of incorporation benefits shareholder welfare.

The major criticism of these studies, however, is that there may be a confounding effect because reincorporations are usually accompanied by other business plans, such as mergers and acquisitions, or alternatively, adoption of anti-takeover provisions (see Bebchuk, 1992; Bebchuk & Hamdani, 2002). In the case of reincorporations into Nevada, the problem of confounding effect appears to be a lesser problem. As discussed in section 4, a large number of firms reincorporating into Nevada are simultaneously undergoing changes to their equity structure, such as reverse stock splits or increases to their authorized shares. Reverse stock splits are usually associated with a negative stock price effect (Kim et al., 2008). Increases in authorized shares suggest that the firm may issue new stock and dilute the shareholding of the current shareholders. Moreover, they are typical for small firms with high “burn rate” (i.e., negative cash flow), and therefore signal to investors that the firm might be in financial trouble. Therefore, to the extent that Nevada reincorporations are associated with positive stock price effect, the confounding effect would, if anything, bias the results down rather than up. In addition, it is easy to examine the effect of Nevada reincorporation on firms that have not undergone major changes to their equity structure on the relevant event dates.

The third method of evaluating the effect of corporate law on firm value is to study the impact of changes in states’ laws on firm value. The main methodology in such studies is to do an event study of such legal changes. Many event studies, for example, examine anti-takeover statutes (Karpoff & Malatesta, 1989; Karpoff & Malatesta, 1995; Jahera & Pugh 1991; Pugh & Jahera, 1990; Sidak & Woodward, 1990; Romano, 1987; Szewczyk & Tsetsekos, 1992; Alexander et al., 1997; Ryngaert & Netter, 1988; Margotta et al., 1990). My study is closely related to event studies of Delaware’s limited liability statute, which generally find that this law had no significant stock price effect (Bradley & Schipani, 1989; Janjigian & Bolster, 1990; Romano, 1990). Delaware’s limited liability law essentially allowed firms to exempt directors from liability for violating the duty of care if the corporate charter so provides. Accordingly, the act itself did not affect the liability of managers when the act was introduced or passed, as it required further shareholder approval for the exemption to occur. Thus, the results of these studies are not surprising.<sup>10</sup>

In contrast, the Nevada 2001 law reform had mandatory effect by exempting all managers of Nevada firms from liability not only for the duty of care, but also from the duty of

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<sup>10</sup>Romano (1990) finds that firms that chose to exempt their directors from the duty of care experienced a positive price effect.

loyalty.<sup>11</sup> This level of exemption for directors was not in fact unique, as states such as Wisconsin afforded similar protection to their directors,<sup>12</sup> but no other state has extended to date such exemptions to officers. For obvious reasons, this law carries the risk that managers of Nevada firms, especially officers who own a stake in the firm, might advance their interests at the expense of shareholder value. However, if such laws had positive or no material stock price effects, then investors presumably did not perceive them as increasing managerial rent-seeking in Nevada firms.<sup>13</sup>

It is important to emphasize, though, that evaluating the stock price effect of changes in corporate law on heterogeneous firms may not be a reliable test of the effect of the law without accounting for firm governance provisions. Prior to the 2001 law reform, Nevada firms were allowed to exempt their directors and officers from the duty of loyalty through charter provisions. The major effect of the 2001 law reform was to make such exemption mandatory. Therefore, it is necessary to compare the effect of the reform on firms that had already exempted directors and/or officers from the duty of loyalty prior to 2001 (and were therefore unaffected by the law reform) to those that had not.

In fact, one recent study by Donelson & Yust (2014) of the Nevada law reform fails to do this, and only examines the effect of the law reform on all Nevada firms. This omission underestimates the extent to which Nevada law was already relatively protective of managers. In my sample, about two thirds of the firms had such an exemption in their charter. Their study thus assumes with no clear explanation that investors were unaware that many Nevada firms already exempted managers from fiduciary duties.<sup>14</sup> Moreover, the results of their study, which finds some evidence that the Nevada law reform had a negative effect on stock prices, seem to be driven mainly by the choice of control group. The control group in their study is a matched sample of firms incorporated out of Nevada in same industry with similar market value. However, Nevada firms may be different from non-Nevada firms with respect

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<sup>11</sup>The duty of care, which is generally associated with a gross negligence standard, is usually protected by the business judgment rule. The business judgment rule means that in the absence of a conflict of interest, there is a presumption that managers did not violate their fiduciary duties. Thus, courts rarely find managers to be liable for breaching the duty of care. The duty of loyalty, by contrast, prevents managers from advancing their own self-interest by diverting corporate assets, opportunities or information for personal gain, and breaches of this duty are not typically protected by the business judgment rule.

<sup>12</sup>Wis. Stat. Ann. § 180.0828; see further DeMott (1988).

<sup>13</sup>The Nevada law was later modified in 2003 to allow firms to opt out of the exemption and impose liability on their officers and directors. However, as documented in other research, corporate default laws are rarely modified, especially when they benefit managers (Listokin, 2009), and hence the 2003 amendment is unlikely to have a large impact on firm governance provisions.

<sup>14</sup>A standard assumption underlying event studies is that investors are rational and informed.

to other observable and unobservable factors. A legitimate control group in this context should include stocks that have the same sensitivity to the relevant factors prior to the event, and matching by other variables can distort the event study methodology. Moreover, it is doubtful that there is a need for a control group in this event study, since the purpose of the event study methodology is to examine if share prices' sensitivity to certain factors has changed in the relevant event window due to the event. But, it does not overrule the possibility that other companies have different sensitivity to share prices, and therefore would appear to experience abnormal returns compared to the treated group. My study shows that when using a standard event study methodology, there is no evidence that the 2001 law had a negative stock price effect.

Donelson & Yust (2014) also seek to show that after the 2001 law reform, the Tobin's Q score of Nevada firms has declined. However, their sample is limited because they do not appear to have the accurate state of incorporation of a large sample of firms over time. Therefore, they are compelled to exclude firms that reincorporated in and out of Nevada. The sample of firm incorporation over time that I use in this article allows me to test this claim with greater accuracy.<sup>15</sup> The results I obtain under different specifications do not support the claim that the 2001 law reform has had a negative effect on Tobin's Q.

Finally, to explore the channel through which Nevada law affects firm value, I examine the relationship between Nevada corporate law and the probability of takeovers and litigation. Both takeovers and litigation are viewed as mechanisms for disciplining managers and increasing their accountability to shareholders. However, such mechanisms may also increase the costs of corporate governance when managers would prefer to focus on growth as opposed to responding to bids or defending against litigation. Daines (2001) shows that Delaware firms are more likely to receive bids. Moreover, several studies have shown that

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<sup>15</sup>Their final sample consists of very few observations (132 firms and 2,370 firm year observations), which include Nevada firms with at least one year of data prior to and after the 2001 law reform, and a sample of firm year observations of non-Nevada firms matched by market value, year and industry. They then show that the interaction effect between Nevada incorporation and Post, a dummy equal to 1 if the fiscal year starts on or after July 2001, is negative. They justify using such a small sample with few or no reincorporations by arguing that the firms that reincorporated into Nevada are "bad" anyway, and that only a few firms reincorporated out of Nevada. However, even if firms that have reincorporated into Nevada are "bad", it does not follow that Nevada law harms their value. In addition, in my sample there are 60 reincorporations out of Nevada (53 of which into Delaware), significantly more than 16, the number of such reincorporations they report based on Barzuza & Smith (2014). In replicating their study, but including firms that incorporate in and out of Nevada (204 firms, 3,030 firm year observations, 12 reincorporation into Nevada and 12 reincorporation out of Nevada, all to Delaware), the interaction effect is negative, but not statistically significant, and its magnitude is trivial as compared to a much larger coefficient on Nevada incorporation. At any rate, with a large sample of firms, there is no apparent justification for limiting the data to such a small sample of firms.

most merger deals in recent years are challenged by shareholder suits (C. N. V. Krishnan et al., 2012; Cain et al., 2014). More recently, a Wall Street Journal article has suggested that deals that take place in Delaware are more likely to be litigated (Hoffman, 2015). Thus, there is evidence that Delaware firms are likely to face significant corporate governance costs. These costs may be particularly high for small firms with few resources, and the migration of such firms to Nevada as an alternative venue to Delaware may be associated with the desire to reduce such costs. Accordingly, a finding that Nevada firms are less likely to be acquired or face litigation could explain why Nevada corporate law may be conducive to shareholder value of firms that self-select into Nevada, or at least does not have any material adverse effect on such value.

To examine this hypothesis, my study employs standard models of takeover probability to assess the probability that Nevada firms receive takeover bids or are subject to completed takeovers (see Cremers et al., 2009). Unlike other studies, I also examine the conditional probability that a firm is acquired given that it received a bid. This is important for assessing whether a lower takeover probability is driven by a lower probability of receiving a bid, or stronger legal tools for defending against a bid once it is made.

In addition, I study the relationship between litigation risk and Nevada incorporation. As a proxy for litigation risk, I use available data on federal securities class action litigation (see Rogers and Stocken, 2005; Brochet and Srinivasan, 2013; Wilson, 2015). To be sure, this data is inherently imperfect for my study since state liability provisions cannot exempt managers from liability for violating federal securities laws. However, since federal securities law cases often involve breaches of fiduciary duties (Erickson, 2010), they are arguably a reasonable proxy for litigation risk under state laws, and one recent study indeed uses them for this purpose (Wilson, 2015). Therefore, the results of this study should be viewed as suggestive only, though as I show below, the results support the hypothesis that Nevada incorporation is correlated with lower litigation risk.

### **3 Tobin's Q Regression**

#### **3.1 Data and Research Design**

The underlying data for the Tobin's Q regressions is based on the data used in Eldar & Magnolfi (2016) to analyze firms' incorporation decisions between 1995 and 2013. The

sample includes public firms from the Compustat database that also have public disclosure documents available on SEC servers, excluding financial firms, utilities and firms incorporated outside the U.S. The accurate state of incorporation over time is sourced directly from public disclosure documents by parsing the state of incorporation from regular expressions on 10-K, 10-Q and 8-K forms.<sup>16</sup> I obtain financial and accounting information for each firm from Compustat. Following Gompers et al. (2003), I compute Tobin's Q as the ratio of the market value of assets to the book value of assets, where the market value is calculated as the sum of the book value of assets and the market value of common stock less the book value of common stock and deferred taxes. To reduce sensitivity to outliers, I trim observations with Tobin's Q values in the upper and lower 5% of the sample, and I winsorize all the control variables at the 1% level.

The variable of interest in the Tobin's Q regressions is a dummy variable (Nevada) which denotes incorporation in Nevada, but I also control for Delaware incorporation with a corresponding dummy variable (Delaware). I include a variety of controls which have been used in prior studies, including the log of the book value of assets (Log(Assets)), book leverage as the ratio of the sum of total liabilities over the book value of total assets (Leverage), the ratio of research and development expense over the book value of total assets (R&D Ratio), and the ratio of capital expenditures over the book value of total assets (Capex Ratio).

The final sample includes 73,889 firm year observations, and 9,917 firms. 697 firms in the sample (3,231 firms year observations) are incorporated in Nevada. Summary statistics are presented in Table 1. Nevada firms have higher Tobin's Q compared to the total sample and to Delaware firms. The median Tobin's Q of Nevada firms is 1.93 as compared to the sample median of 1.60 and 1.63 of Delaware firms. Nevada firms are on average much smaller than Delaware firms by any measure. For example, the median firm in Nevada has \$16.79 million in assets, while the median firm in the sample and the median Delaware firm have \$160.59 and \$211.95 million worth of assets respectively. Nevada firms also seem to have higher leverage and lower R&D Ratio, but higher Capex Ratio. It is also noteworthy that a large percentage of Nevada firms are traded over the counter (OTC) rather than on a major stock exchange (approximately 70.3% of firm year observations).<sup>17</sup> Arguably, OTC

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<sup>16</sup>For more detail on the data construction, see Appendix C in Eldar & Magnolfi (2016).

<sup>17</sup>The market share of Nevada among OTC firms has increased steadily in the sample period from less than 1% to nearly 40% of the firms, while the share of Delaware firm decreased from 61% to 38%. Note that this is in large part due to the relative decrease of the percentage of OTC firms in the sample from around 35% in the late 1990s early 2000s to less than 20% in 2013.

firms are more susceptible to managerial opportunism created by Nevada’s lax laws because they are not subject to SEC regulations, though, as I show below, all the results are robust to specifications that include only OTC firms.

Because Nevada firms are small and have relatively few assets compared to the firms in the sample, there is a concern that the Tobin’s Q is not well measured for Nevada firms. Moreover, when there is a large difference between groups of firms in covariate distributions, linear regression relies heavily on extrapolation, and thus will be sensitive to the exact functional form (Imbens & Rubins, 2015). To address this problem, I use matching estimators to compare Nevada firms to similar firms in other jurisdictions. I focus on matching by size, but I also include specifications with other variables, including institutional shareholding, managerial ownership, and time and industry dummies. Data on institutional shareholders is sourced from Thomson Reuters 13F filings and data on the percentage of insider ownership from Thomson Reuters filings of forms 3,4 and 5 (see Panousi & Papanikolaou, 2012). As shown in Table 1, Nevada firms have relatively low institutional shareholding and high managerial ownership as compared to other firms in the sample.

### 3.2 Results

The results depicted in Table 2 confirm the standard result that Delaware firms have higher Tobin’s Q whether one uses an OLS model or a random effect model. However, both models also suggest that the correlation between Nevada incorporation and Tobin’s Q is much higher. The average Nevada effect amounts to 0.504 in the OLS specification and 0.569 in the model with random effects. This is the first and relatively straightforward evidence that Nevada law does not harm shareholder value, and might in fact increase it.

This result, however, should be treated with caution. As stated above, the standard computation of the Tobin’s Q measure is such that it potentially biases the level of performance of small firms that have few assets, simply because dividing by total assets exaggerates the performance levels of small firms with mainly intangible assets, though dividing most control variables by assets arguably helps correct this bias. As a first step to address this issue, I interact the Nevada dummy with measures of asset size. In all specifications, the correlation of Nevada with Tobin’s Q significantly decreases for larger firms that have more than a certain quantity of assets, depending on the specification. Because the median  $\text{Log}(\text{Assets})$  is 5.08 (which is equivalent to \$160.59 million), the “Nevada effect” almost disappears for the median firm in both columns 2 and 6, and is easily negative for large firms with more

than \$1 billion in assets. The Nevada effect further significantly decreases or completely disappears when interacting the Nevada dummy with dummies that equal 1 if the firm has more than \$50 or \$100 million in assets. Accordingly, there is reason to believe that the positive correlation of Nevada incorporation and Tobin's Q is limited to small firms. Thus, there is a concern that most of the "Nevada effect" is driven by small firms for which Tobin's Q is not well-measured (as explained above).

To further investigate this, I split the data into firms with less and more than \$50 million in assets, and I run again the OLS and random effects regressions using these two groups. I also run the regression using \$100 million as the cut-off point (instead of \$50 million). As shown in Table 3, the Nevada effect disappears in the sample with the larger firms, whereas in the sample with the smaller firms, the Nevada dummy is correlated with a very high Tobin's Q. For example, the coefficient on the Nevada dummy is 0.505 in column 2 and 0.641 in column 6. The Nevada effect for smaller firms again exceeds Delaware's. This is the case despite the fact that even for smaller firms, Delaware incorporation is associated with higher Tobin's Q. By comparison, the Delaware effect persists both in the sample of the smaller firms and the sample of the larger firms. Note, however, that the Delaware effect is greater for smaller firms than it is for larger firms, which again suggests that Tobin's Q is potentially not measured well across different firm sizes. This analysis further motivates the need to use matching estimators to evaluate the relationship between Nevada law and Tobin's Q.

Table 4 shows the results of the matching estimators, where the relevant treatment effect is either Nevada or Delaware incorporation. I use several different specifications. The first model simply matches firms by size. In the second model, I add the percentage of institutional shareholdings and insider ownership. In the third, I further add year and industry dummies, expenses on research and development, capital expenditure, and total liabilities. I use bias adjustment for every specification, which is necessary to obtain consistent results.

The interesting result is the contrast between the average treatment effect (ATE) of Nevada law and the average treatment effect on the treated (ATET). The ATE is either negative or very small and not statistically significant. This suggests that the average firm would not benefit from incorporating in Nevada. By contrast, the ATET of Nevada law is always highly positive and statistically significant. Subject to the problem of selection bias discussed above, this means that Nevada corporate law positively affects Tobin's Q for the firms that actually choose to incorporate in Nevada. In addition, when the data is again split into smaller and larger firms, the ATE of Nevada law for smaller firms is positive,

while the ATE for larger firms is negative. By comparison, when the treatment is Delaware incorporation, both the ATS and the ATET are positive, and Delaware firms, whether larger or smaller, have higher Tobin's Q.

I note that these results are generally robust to several specifications. First, the results are overall robust to using median regressions, which estimate the median of the dependent variable (i.e., Tobin's Q) conditional on the values of the independent variables, primarily Nevada and Delaware incorporation. Second, even if we consider only OTC firms, there is a positive association between Nevada (as well as Delaware) incorporation and Tobin's Q, whichever econometric model we use. This addresses the concern that managers of OTC firms, which are not subject to securities regulations, might be more likely to exploit Nevada law to benefit themselves at the shareholders' expense. Third, the results are largely the same when the sample is restricted only to mature firms with at least 5 years of observations and without firms that reincorporated in the sample period, even though these omissions substantially change the number of Nevada firms in the sample.<sup>18</sup> Fourth, in unreported specifications, I also run regressions where Tobin's Q is winsorized at the 5% level, and where the number of Nevada observations and firms is higher (4,688 firm year observations and 915 firms, respectively), and the results are largely the same. The results are also robust to using the natural logarithm of Tobin's Q winsorized or trimmed at the 1% level.

Finally, I note again that the results are unavoidably susceptible to selection bias. However, it is doubtful that selection bias alone accounts for them. For example, the matching estimators suggest that the average Nevada effect on firms that incorporate in Nevada (i.e., the ATET) amounts to 7.3%-16.82%.<sup>19</sup> Unless there is some powerful channel through which firms with very high Tobin's Q choose Nevada, the evidence suggests that Nevada law does not harm firm value measured by Tobin's Q.

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<sup>18</sup>The results of the OLS and random effect regressions are substantially the same as in Tables 2 and 3; the only difference is that under column 3 of Table 3, the t-statistic for the coefficient on Delaware is 1.61, and hence not significant at the 10% level. The matching estimators also generate similar results with minor differences. In model 1 of Table 4, the Nevada ATET is positive but not statistically significant at the 10% level. This is not surprising because this model matches firms by assets only, and the sample of mature firms is skewed towards larger firms. This sample contains only 2,376 firm year observations (338 firms) for firms incorporated in Nevada, about 73% of the observations in the main sample described in Table 1. By comparison, the redacted sample includes 37,502 observations (3,701 firms) of Delaware incorporated firms, which is about 83% of the observations in the main sample. The mature firms also tend to be a bit larger; the average firm has about \$2.45 billion in assets as compared to \$1.94 billion.

<sup>19</sup>Based on dividing the regression coefficient by the sample average.



## 4 Reincorporations into Nevada

### 4.1 Data and Research Design

From the full sample (including financials, utilities and firms headquartered in a foreign jurisdiction), I obtain a list of firm reincorporations into Nevada. The total number of reincorporations into Nevada is 132. There is no specific industry to which firms reincorporating into Nevada belong, although 14 are computer software companies, 13 oil and petroleum companies and 10 belong to the entertainment industry. The firms that change their state of incorporation tend to be small, though those reincorporating into Nevada seem to be even smaller. The median size of a firm reincorporating into Nevada is \$15.15 million in assets, while the median firm that reincorporates into Delaware has \$95.92 million in assets. Moreover, firms reincorporating into Nevada tend to have fewer institutional shareholders and more insider ownership as compared to those reincorporating into Delaware (13.34% and 7.03% average respectively compared to 36.34% and 4.44% for Delaware firms).

Unlike studies of reincorporation into Delaware, there are relatively few instances where the reincorporation is accompanied by a merger or a takeover bid. In fact, the main transactions that take place concurrently with the reincorporation are reverse stock splits or increases in authorized shares. 49 firms in the sample undergo either a reverse stock split (27 firms) or resolve to increase their number of authorized shares (33 firms) or both. The decision to do a reverse stock split is usually driven by a drop in stock prices which could result in a de-listing of the firm. A decision to increase authorized shares is typically made in anticipation of new issuances in the future which could drive down share prices if existing shareholders might be diluted in the future. As mentioned above, it might also be associated with a high “burn rate” (negative cash flow), particularly for small firms. This suggests that many firms that move to Nevada are either facing financial difficulties or looking for new growth opportunities.

A majority of the reincorporating firms come from three states. 53 of the reincorporations are from Delaware, 16 from Colorado and 8 from California. All these states afford little protection from liability to their directors and officers. These states allow firms to limit the liability of directors only if they acted in good faith. This essentially prevents firms from limiting the liability of directors for breaches of the duty of loyalty.<sup>20</sup> Moreover, none of

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<sup>20</sup>In fact, California also does not allow firms to limit the liability of directors for any action that constitutes

these states allow firms to limit the liability of officers from any fiduciary duty, including not only the duty of loyalty but also the duty of care.<sup>21</sup>

In fact, from reviewing the proxy statements of these firms, about 39 expressly emphasize the need for greater liability protection for their directors and officers as one of the reasons for reincorporating. 85 firms revised their articles of incorporation at the time of the reincorporation. Interestingly, 57 of the 85 also specifically provide in the articles that the directors will be exempted from liability to the maximum extent provided under Nevada law, and 41 provide the same with respect to officers. This occurred despite a Nevada law enacted in 2001 that has made directors and officers exempt from liability for the duty of loyalty. This law was amended in 2003 to allow firms to opt out of the exemption by including a provision in the charter to that effect. But, with perhaps one exception, none of the reincorporating firms seems to have reversed the default exemption at the time of its reincorporation.<sup>22</sup>

Similarly, the degree of anti-takeover protection in the states from which firms reincorporate into Nevada seems to be low. Based on the anti-takeover index of Bebchuk & Cohen (2003), the number of anti-takeover statutes in those states tends to be lower than the average in the sample (1.90 per state as compared with 3.03 in the sample period). Moreover, a majority of 71 firms come from states, principally from Delaware and California, that do not have a poison pill statute. Poison pills are generally regarded as the most effective anti-takeover devices (Coates, 2000). While Delaware generally permits the use of poison pills, it also subjects them to judicial scrutiny (Barzuza, 2009; Eldar & Magnolfi, 2016). Poison pill statutes protect poison pills from judicial scrutiny. In contrast to Delaware, Nevada has five anti-takeover statutes, including a poison pill statute.<sup>23</sup> Moreover, it has a statute that expressly rejects the judicial standards applicable under Delaware law to all anti-takeover

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inexcused inattention (California; Cal. Corp. Code § 204(10)). This essentially prevents firms from limiting the liability of directors for breach of their duty of care. Delaware and Colorado, on the other hand, do allow firms to exempt their directors from breaches of the duty of care, but not from the duty of loyalty; see Del. Code Ann. tit. 8, § 102(b)(7) and Colo. Rev. Stat. Ann. § 7-108-402

<sup>21</sup>On the measure of director and officer protection (*DIR* and *OFF* respectively) constructed by Eldar & Magnolfi (2016), the scores of California, Colorado and Delaware, respectively are 0.33,1.33,1.33 for director protection and 0.33,0.33,0.33 for officer protection as compared to Nevada's score of 6 and 6 from 2001. The mean *DIR* and *OFF* of the states from which firm reincorporate into Nevada are 1.59 and 0.56, respectively.

<sup>22</sup>The articles of Kent Financial Services provide that directors' liability cannot be limited or exempted if the director did not act in good faith. The firm, which reincorporated from Delaware, essentially maintains the Delaware standard for the limitation of liability for directors; see <https://www.sec.gov/Archives/edgar/data/316028/000114036106016073/def14c.htm>. Note however that because the articles do not mention officer liability, the officers are exempted by default from the duty of loyalty, whereas prior to the reincorporation, the officers were personally liable for any breach of their fiduciary duties.

<sup>23</sup>Nev. Rev. Stat. Ann. § 78.195.

defenses.<sup>24</sup>

It is important to emphasize that 50 firms cite the lower franchise fees in Nevada as a reason for the reincorporation. As is well known, Delaware charges relatively high fees based on a formula that depends mainly on the dollar amount of the firm's assets and the number of its authorized shares, and is subject to a cap of \$180,000 per annum. In contrast, Nevada charges an initial fee that can reach \$35,000, but the annual fees are trivial. Given the large number of firms that reincorporate into Nevada from Delaware, it is intuitive to argue that the high franchise fees in Delaware might be the major reason for the migration of firms into Nevada. However, while fees are likely to be an important consideration, this argument is not without difficulty. Many of these firms can incorporate in their home state, where the annual fees are also very low. For example, California annual franchise fees are trivial, and California's income tax applies to California headquartered firms anyway. Therefore, saving taxes or franchises fees is unlikely to be a primary motivation for California firms in choosing Nevada as the state of incorporation.

Finally, another attractive feature of Nevada law is that it generally allows the board to effect reverse stock splits or change the number of authorized shares without shareholder approval.<sup>25</sup> Although Nevada is not unique in this respect,<sup>26</sup> most states, including Delaware, do not give managers such power. As stated above, a relatively large number of firms reincorporating into Nevada undergo reverse stock splits and/or increase the number of their authorized shares, and several firms expressly cite this provision as an important reason for the reincorporation.<sup>27</sup>

I obtain data on stock prices from several sources. This is because, for many of the reincorporating firms, there is no data available on stock returns on CRSP. Therefore, I also obtain data on such securities from Datastream and Global Financial Data. I drop 18 firms for which there is no relevant return data around the event date. I use a number of event windows in the analysis and an estimation window of 180 days prior to the event window.

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<sup>24</sup>Nev. Rev. Stat. Ann. § 78.139(2); see Barzuza (2012).

<sup>25</sup>Nev. Rev. Stat. Ann. § 78.207.

<sup>26</sup>Maryland corporate law has similar provisions; see Md. Code Ann., Corps. & Ass'ns § 2-309(e).

<sup>27</sup>For example, the 1997 proxy statement of Juniper Group Inc. states: "If the Reincorporation is not approved and the Company continues to be incorporated in New York, the reverse stock split could be effected only by an amendment to the Company's Certificate of Incorporation, which would have to be approved by the Shareholders at a special meeting of Shareholders. The Company would avoid both the expense and uncertainty of such a meeting if the Company were reincorporated in Nevada. There can be no assurance that if the Reincorporation is approved, the Board will effect one or more reverse stock splits or that the Company's Common Stock will not be delisted from Nasdaq SmallCap."

The event date of each reincorporation is the date of the preliminary proxy statement (if available), and if no preliminary proxy statement was filed, the date of the proxy statement itself. The rationale is that although shareholders vote only on the meeting date, these proposals are typically adopted and their acceptance is anticipated by the market when the proxy materials become public (Bhagat & Romano, 2002). If no proxy was filed, I use the date of the first public disclosure that discusses the reincorporation.

A problem with conducting the event study is that many of the remaining 114 firms are thinly traded, i.e., there are missing trading days for at least some days in the event window and estimation window respectively. Out of 114 firms, 78 are traded over the counter, 1 on the pink sheets, and only 35 on a major stock exchange (8 on the New York Stock Exchange, 25 on Nasdaq and 2 on the American Stock Exchange). I treat days as “no trade” days if the return is missing or zero, and the volume of trading is lower than the 10th percentile of trading volume for the relevant firm. I do not drop all firms for which there are missing trading days. Instead, I use a trade-in-trade method discussed in the next sub-section to adjust the standard factor models for computing cumulative abnormal returns. I require a sufficient number of trading days using two main rules: First, there must be at least 30 trading days in the estimation and event windows together. Second, the number of trading days in the event window must be larger than one half of the length of the event window. For example, if the event window consists of three days (-1,1), there must be at least two trading days. The final sample consists of 72 to 76 firms depending on the event window.

## 4.2 Model

As a baseline model before accounting for no-trade days, I use the Fama-French factor model to compute abnormal returns on the relevant dates within the event date and the event window. The cumulative abnormal returns is simply the sum of abnormal returns on the event dates. The standard model is summarized in the following three equations:

$$R_{j,t} = a_j + \beta_{j,m}RM_t + \beta_{j,smb}SMB_t + \beta_{j,hml}HML_t + \varepsilon_{j,t}, \quad (1)$$

where  $RM_t$ ,  $SMB_t$ , and  $HML_t$  are the market portfolio, the size factor, and the book-to-market factor respectively.<sup>28</sup> The abnormal returns and cumulative abnormal returns are

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<sup>28</sup>The rationale for using the factor model is that since the firms that reincorporate into Nevada are small, there is a need to control for the size factor; in any event, the results are robust to using the market model.

defined as follows:

$$AR_{j,t} = R_{j,t} - E(R_{j,t}) \quad (2)$$

$$CAR_j = \sum_{t=0}^T AR_{j,t} \quad (3)$$

Following Maynes & Rumsey (1993), when there are missing trading days, I calculate the observed multiperiod return ending on day  $t$  as follows:

$$R_{j,n_t} = \ln \left( \frac{P_{j,t}}{P_{j,t-n_t}} \right) = \ln \left( \frac{P_{j,t}}{\hat{P}_{j,t-1}} \times \frac{\hat{P}_{j,t-1}}{\hat{P}_{j,t-2}} \dots \frac{\hat{P}_{j,t-n_t+1}}{P_{j,t-n_t}} \right) \quad (4)$$

where  $n_t$  is the length of the return interval ending day  $n_t$ , and  $\hat{P}_{j,t-s}$  is the unobserved price for day  $t-s$  and  $s = 1, \dots, n_t - 1$ . The basic assumption here is one of an underlying stationary one day return generating process. The Fama French factor model then becomes,

$$R_{j,n_t} = a_j n_t + \beta_{j,m} RM_{n_t} + \beta_{j,smb} SMB_{n_t} + \beta_{j,hml} HML_{n_t} + \sum_{s=0}^{n_t-1} \varepsilon_{j,t-s}, \quad (5)$$

where  $RM_{n_t}$ ,  $SMB_{n_t}$ , and  $HML_{n_t}$  are the trade to trade returns for factors calculated to match the return period of the stock return. The abnormal returns and cumulative abnormal returns are given by equations 2 and 3 above, except that  $t$  only takes the value of days in which there is a trade. Note that this model does not require making assumptions on the distribution of non-trading days to adjust for non-synchronous trading (see Scholes & Williams, 1977).

### 4.3 Results

The results are depicted in Table 5. Panel A shows the results for the full sample, and Panel B the results for firms that did not undergo reverse stock splits or increased their authorized share capital. The cumulative abnormal returns of reincorporating firms are usually positive, irrespective of the event date and the group of firms chosen for study. The main exception is the event window (-1,1) for the full sample, but this result is mainly due to firms that undergo reverse splits or increase their authorized shares. In fact, the cumulative abnormal returns for reincorporating firms that undertook such changes to their equity are

negative and often statistically significant at the 10% level.<sup>29</sup> The cumulative abnormal returns for other firms tend to be more positive, and for event windows (0,3) and (-1,5) they are also statistically significant at the 10% level.

Column 2 includes results for firms that filed a proxy statement prior to the reincorporation. Because the disclosure on the reincorporation is untimely without a proxy statement, it is likely that the market has better information on firms that file proxy statements before reincorporating. The results however are not materially different from the total sample in column 1.

Columns 3 and 4 show results for (a) firms that reincorporate from Delaware and from states that do not allow firms to exempt their managers from the duty of loyalty (particularly, California, Colorado, Texas as well as Delaware) after the 2001 law reform, and (2) firms that reincorporate from those states prior to 2001 law reform, but amended their articles of incorporation to exempt managers from the duty of loyalty. The managers of these firms became protected from liability for the violation of their duty of loyalty either by virtue of the firms' reincorporation into Nevada after the 2001 law reform or through a charter amendment prior to the 2001 law reform. Again, the results are similar to the results for the total sample in column 1, though note that for stocks that did not undergo change to their equity the effect is positive even for the event window (-1,1).

There is a further concern that firms controlled by their managers might want to move to Nevada to benefit from liability protection. However, as shown in columns 5 and 6, there seems to be little evidence that firms with managerial ownership higher than 25% fare better or worse than those with less than 25%. This result is robust to considering firms with more or less than 50% of managerial ownership. In addition, when regressing cumulative returns on the percentage of insider ownership the coefficient on the percentage of insider ownership are close to zero and statistically insignificant.

Moreover, the effect of reincorporation on the share prices of firms that are traded on a major stock exchange (column 7) is negligible for the full sample, and positive for firms that did not undergo a reserve split or increase their authorized shares. The price effects on firms traded over the counter (column 8) tend to be larger, probably because their share prices are lower; again, this addresses the concern that OTC firms may be more susceptible to managerial opportunism created by Nevada's laxity because they are not subject to SEC

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<sup>29</sup>The cumulative abnormal returns for firms that undergo reverse splits or increase their authorized shares are: -0.122 (-1.84), -0.100 (-1.49), and -0.126 (-1.74) for event windows (-1,1), (0,3) and (-1,5) respectively (t-statistics are in parentheses).

regulation. Finally, as shown in column 9, when I exclude financials, utilities and foreign firms (i.e., firms headquartered outside the US or firms that reincorporated from a jurisdiction outside the US), the results are either trivial (Panel A) or positive but not statistically significant (Panel B). The results are robust to using the market model and the Carhart four factor model and to winsorizing the cumulative abnormal returns at the 5% level.

## 5 The 2001 Law Reform

### 5.1 Data and Research Design

In this section, I examine the effect of the 2001 law reform on firms that were already incorporated in Nevada. As stated above, the law exempted all managers of Nevada corporations from liability for the duty of loyalty, except where they engaged in willful misconduct. This study is important for assessing how Nevada's liability regime affects not only firms that moved to Nevada to benefit from these laws, but also firms already incorporated therein. The relevant event dates for this study are: (a) May 22 - the date the bill was first discussed in the Senate; (a) May 24, 2001 - the date the bill was introduced in the Senate; (b) May 29, 2001 - the first trading date after the bill was passed by the Senate on Saturday, May 26 (Monday, May 28 was Memorial day); (c) June 4, 2001 - the first trading date after the bill was passed in the Nevada Assembly on Sunday, June 3; and (d) June 15, 2001 - the date the law became effective. There seem to be no major news reports discussing the bills, so in principle each of these dates could have some significance.<sup>30</sup>

There is some debate in the legislature on the merits of the act. Some senators expressed the concern that Nevada would attract disreputable companies (Barzusa, 2012). However, proponents of the bill argued that it would reduce the risk that managers would be subject to costly (and potentially, unmeritorious) shareholder lawsuits in the context of mergers, acquisitions and issuance of stocks.<sup>31</sup> At any rate, the bills passed with unequivocal majorities both in the Senate and the Assembly.<sup>32</sup>

From the full sample of firms incorporated in Nevada in 2001, I keep only firms that have

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<sup>30</sup>Donelson & Yust (2014) focus on the event window June 1 - June 7, based on the argument that these dates allowed investors to impound the impact of the law change, but there seems to be no evidence that these dates revealed any major news, given that the law had already passed in the Senate on May 26.

<sup>31</sup>Hearing on S.B. 277 Before the S. Comm. on Judiciary, 2001 Leg., 71st Sess. (Nev. 2001), available at <https://www.leg.state.nv.us/Session/71st2001/Minutes/Senate/JUD/Final/1464.html>

<sup>32</sup>The bill passed in the Senate by a majority of 18 to 1 (2 excused), and in the Assembly by a majority of 40 to 0 (2 excused).

data in CRSP on the relevant event dates. The estimation period is 180 days ending one month before the bill was introduced. In general, I use the event window (-1,1), except with respect to the second and third event dates (i.e., May 24, 2001 and May 29, 2001) where I use the event window (0,1) because otherwise the event windows would overlap.<sup>33</sup> I keep firms that have at least two trading days within each event window and firms that have return data for at least 80 percent of the days in the estimation period. The remaining sample consists of 106 firms.

I use the Fama-French factor model as the benchmark to measure the announcement returns around the relevant event dates:

$$R_{p,t} = a_p + \beta_{p,rm}RM_t + \beta_{p,smb}SMB_t + \beta_{p,hml}HML_t + \gamma D_t + \varepsilon_{p,t}, \quad (6)$$

where  $R_{p,t}$  is the return on the equally weighted portfolio of the firms in the sample,  $RM_t$ ,  $SMB_t$ , and  $HML_t$  are the factor portfolios as defined above, and  $D_t$  is a dummy for the event window dates. The coefficient of interest  $\gamma$  is equal to the abnormal returns associated with the relevant event.

In addition, I also examine larger intervals prior to and around the event dates. The intervals consist of (a) the four week period prior to two days before the event date (i.e., April 23, 2001 - May 18, 2001); (b) one trading day prior to the first discussion of the bill in the Senate until one trading day after the final passage of the bill in the Assembly (i.e., May 21, 2001 - June 5, 2001); and (c) the subsequent period until one trading day after the bill is signed into law (i.e., June 6, 2001 - June 18, 2001). The first period captures the period in which any news may have leaked regarding the law reform; the second period covers the time in which the bill was debated and passed into law; and the third includes the remaining period until one trading day after the law becomes effective.

It is important to emphasize that even prior to 2001, Nevada law allowed firms to exempt their managers from liability to the same extent as under the 2001 law reform if the articles of incorporation so provided. In fact, proponents of the bill in the Senate informed the other senators that firms were already allowed to exempt their managers from liability in the articles of incorporation, and that the act did not increase the standard of liability for which managers can be exempted.<sup>34</sup> Thus, the reform only affected firms that had not already

<sup>33</sup>The results are robust to using the event window (-1,1) with respect to the second and third event dates as well.

<sup>34</sup>As stated by Senator Bonner: "The distinction between the law today and the proposal is that this will be self-executing, meaning a corporation will not have to adopt an amendment to its articles of incorporation;" see Hearing on S.B. 277 Before the S. Comm. on Judiciary, 2001 Leg., 71st Sess. (Nev. 2001), available at



had such an exemption in their charters. Accordingly, I have hand-collected the articles of incorporation for the firms in the sample that were effective as of May 2001 to examine if these firms had already exempted their directors and/or officers from liability. Out of 106 Nevada firms, 80 had exempted their directors to the fullest extent provided under Nevada law prior to 2001, and 71 had exempted their officers to the same extent. All the firms that exempted their officers also exempted their directors. Thus, the act effectively changed the law of at least 35 firms in the sample. I examine the effect of the 2001 act on both affected firms and unaffected ones.

Finally, to test the hypothesis that the 2001 law decreased the Tobin's Q of Nevada firms, I run the Tobin's Q regressions in section 3, but I include two additional variables: (1) Post, a dummy equal to 1 if the fiscal year started after July 1, 2001; and (2)  $NV \times Post$ , an interaction variable between Post and Nevada incorporation. The second variable is the variable of interest, because it arguably captures the effect of the Nevada law reform on Tobin's Q. As in section 3, I run both the OLS and random effects models, and I conduct several robustness tests using different samples.

## 5.2 Results

The results of the event study suggest that the 2001 law reform had no negative impact on firm value. Panel A of Table 6 presents the results for the short intervals around the five event dates. On the date that the law was first discussed in the Assembly, the stock price effect of the law is positive and statistically significant at the 10% level, particularly for affected firms, i.e., firms that had no provision in their articles exempting directors or officers from liability for breaches of the duty of loyalty. Other event intervals however do not yield any statistically significant results. This suggests that the effect of the act was positive, if the major event was the discussion of the bill on May 22. The fact that the law passed twice with a large majority lends support to this view. On the other hand, when we sum up the abnormal returns on the relevant event dates, the results are not statistically significant, and thus, it is possible that the act had no major impact on stock prices.

Panel B shows the results when examining larger intervals around the event dates. There seem to be no significant effect in the periods prior to the discussions of the bill in the Senate, or after the passage of the act. There is a small positive effect in the period in which the law was debated and eventually passed, although it is not statistically significant.

<https://www.leg.state.nv.us/Session/71st2001/Minutes/Senate/JUD/Final/1464.html>.

Moreover, with respect to all of the event windows, the (unreported) differences between the abnormal returns of the affected firms and the abnormal returns of the unaffected firms are not economically or statistically significant. The results are robust to using the market model and the Carhart four factor model.

Table 7 presents the results of the Tobin's Q regressions. The table shows results not only for the full sample, but also for a sample of mature firms that have at least five firm year observations and have not undergone any reincorporation in the sample period, and similar to Donelson & Yust (2014), firms that have at least one year observation prior to and after the 2001 law reform. The results indicate that there is no negative effect associated with incorporation in Nevada after the act came into force, and the OLS model even suggests that there is a positive effect. These results are generally robust when I split the data into OTC and non-OTC firms, and small firms and large firms using the \$50 or \$100 million in assets as the cutoff; that is, none of the dif-in-dif specification suggests that the 2001 law reform is negatively associated with lower Tobin's Q for Nevada firms.

In summary, while the results are not conclusive as to whether the act had a positive impact on Nevada firms, they suggest that it did not harm shareholder value.

## **6 Nevada Corporate Law and the Costs of Corporate Governance**

In this section, I test the hypothesis that Nevada corporate law reduces the costs of corporate governance. I examine two channels through which Nevada firms face lower cost of monitoring, namely takeovers and litigation. Takeovers discipline managers because an underperforming firm is likely to be acquired and the new shareholders often replace the management team. On the other hand, they may also divert managers' attention from pursuing long-term growth, and focus their efforts on screening takeover bids. Likewise, shareholder law suits deter managers from pursuing their interests at the expense of shareholder value. But with evidence that largely all takeovers are now subject to lawsuits (Cain & Davidoff, 2013), there is a concern that some of them are not meritorious, and could distract managers from managing the business.

## 6.1 The Likelihood of Takeovers

### 6.1.1 Data and Research Design

In this sub-section, I compare the correlation between Nevada incorporation and the probability of takeovers to incorporation in other states, particularly, Delaware. Data on takeover bids and completed takeovers is obtained from SDC and is matched to the data described in section 2. I focus on bids to acquire 50% of the company's share. I use a logit model based on the specification of Cremers et al. (2009). Similar to past studies the dependent variable is a dummy that equals 1 if the company receives a bid to acquire 50% of the company's shares or is a target of a 50% completed takeover. The regressions include standard controls, such as Tobin's Q, market capitalization, cash, leverage, the number of takeover bids in the industry in the previous year, and institutional shareholding. I also include as a control a dummy that equals 1 if more than 15% of the firm's shares are owned by managers (Manager > 15%). The rationale is that managers with significant holdings are well positioned to stave off bids. This is a potentially important control since Nevada's firms have a relatively high percentage of insider ownership. The coefficients of interest are the coefficients on the Nevada and Delaware incorporation dummies. All controls are lagged and winsorized at the 1% level.

Table 8 presents descriptive statistics of the total sample, after removing all observations for which there are missing controls. Three main observations emerge from the table. First, as shown in Panel A, a significantly higher percentage of Delaware firms (12.89%) is subject to at least one 50% completed takeover than Nevada firms (5.29%) throughout the sample period of 1995-2013. Second, a higher proportion of Delaware firms (23.98%) receives one bid or more than Nevada firms (11.22%). Third, as shown in Panel B, the percentage of failed bids for Nevada firms (63.33%) is substantially higher than that of Delaware firms (46.51%). Finally, Delaware firms also do slightly better than the total sample of firms in both the percentages of completed takeovers and takeover bids out of the total sample, and have a lower percentage of bid failure.

In additional specifications, I also control for the level of anti-takeover protection in each state, by including a dummy, *Pill Statute*, which equals 1 if the state of incorporation in a given year has a statute that validates poison pill defenses and protects them from judicial review. Nevada has a poison pill statute, and Delaware does not. As discussed in section 4,

while poison pills are permitted in Delaware, they must withstand judicial scrutiny.<sup>35</sup> The goal is to consider whether or not takeover probability associated with each state is related to its statutory provisions or alternatively to other unobservable elements of the state’s political or business environment. For example, leaving selection issues aside, a low probability of takeovers for Nevada (Delaware) firms may emanate from the presence (lack) of a poison pill statute. It may also stem from other unobservable factors associated with the state of incorporation. For example, the quality of Delaware’s judiciary may reduce the costs of transactions, such as mergers, thereby increasing the likelihood of takeovers (Romano, 1985).

Before proceeding with the analysis, it is important to emphasize that controlling for legal characteristics, such as pill statutes, is not likely to be conclusive. This is because it is not possible to separate the unobservable elements of states’ systems from their legal characteristics. Delaware’s system encompasses not only the lack of anti-takeover statutes, but also Delaware’s judicial quality. The Nevada dummy captures both Nevada’s commitment to cater to managerial interests and its anti-takeover statutes. Thus, the coefficients on Delaware and Nevada may be viewed as “bad controls” where the coefficients of interest are the coefficients on anti-takeover statutes;<sup>36</sup> the reason is that the Delaware and Nevada dummies encompass the variable of interest itself. Accordingly, the results of this analysis should be treated with caution.

### 6.1.2 Results

The results of the regressions support the hypothesis that Nevada corporate law is less takeover friendly than Delaware’s. The main results are in Table 9. Interestingly, Nevada incorporation does not seem to be related to a lower probability of receiving bids at a statistically significant level (columns 1 and 3). Columns 1 and 3 confirm the general result in Daines (2001) that Delaware incorporation is associated with a higher probability of receiving bids. Using the Wald statistic to compare Delaware and Nevada coefficients in column 3, the hypothesis that the coefficient on the Nevada dummy is larger or equal to the coefficient on the Delaware dummy cannot be rejected at a statistically significant level (the p-value is only 0.37).

However, as shown in columns 4 to 6, it becomes apparent that Nevada incorporation is associated with a lower probability of completed takeovers, and Delaware with a higher

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<sup>35</sup>See further Barzuza, 2009; Karpoff & Wittry, 2015; Eldar & Magnolfi, 2016.

<sup>36</sup>For a discussion of “bad controls” see Angrist & Pischke (2009).

probability of completed takeovers. Note that the coefficient on the Nevada dummy in column 6 is not statistically significant. However, the Wald statistic indicates that the coefficient on Nevada is smaller than Delaware at a 1% significance level. In columns 7-9, I evaluate the probability of a completed takeover conditional on receiving a bid. In this case, a Nevada (Delaware) incorporation is clearly associated with a higher rate of bid failure (success), and again the difference from Delaware is statistically significant. Accordingly, Nevada incorporation is associated with a lower probability of takeovers, and the channel appears to be not through a lower probability of receiving a bid, but because the probability of bid success appears to be lower. These results suggest that Nevada firms are not necessarily unattractive takeover targets that self-select into Nevada, but rather that Nevada law gives managers stronger tools to defend against takeovers.

In unreported regressions, I restrict the sample to small firms with less than \$50 million in assets. As shown above, these are the firms for which Nevada corporate law appears to be value enhancing. Again, I find that Nevada incorporation is associated with a lower probability of completed takeover (both conditional and unconditional). Moreover, the results for these firms are even stronger in the sense that the difference between the Delaware and Nevada coefficients are economically larger, while still being statistically significant at the 1% level.<sup>37</sup>

In Table 10, I examine whether the difference between Delaware and Nevada is related to the presence of poison pill validation statutes. As shown in columns 1, 3 and 5, the probability of receiving a bid, completed takeovers, and the success of a bid, are all negatively related to the presence of a poison pill statute. This is evidence that supports the hypothesis that the presence of a poison pill statute accounts, at least partly, for the difference between Nevada and Delaware. When we add the Nevada and Delaware dummies, the results are more mixed. With respect to receiving a bid (column 2), only the Delaware effect is statistically significant. In the case of a takeover probability, only the coefficient on *Pill Statute* is statistically significant (column 4), and finally, when assessing the conditional probability of takeovers, only the coefficient on Nevada is significant (column 6). The mixed results are probably partly due to the problem of “bad controls” discussed above. That said, it is important to emphasize that in any of the specifications where we include the state dummies and *Pill*

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<sup>37</sup>For example, the coefficient on Delaware in the logit analysis of the probability of completed takeovers is 0.393 with a t-statistic of 2.63, and the coefficient on Nevada is -0.644 with a t-statistic of 1.67. The coefficients on Delaware and Nevada in the logit analysis of the conditional probability of takeovers are respectively 0.39 (1.74) and -1.00 (-2.21); t-statistics are in parenthesis.

*Statute*, the Wald statistic indicates that we cannot reject the hypothesis that the coefficient on Nevada is larger or equal to the coefficient on Delaware at a statistically significant level. Thus, although these results are not conclusive, pill statutes seem to account at least partly for the difference between Nevada and Delaware.

Finally, in unreported specifications, the results in Table 9 and columns 1, 3 and 5 of Table 10 are all robust if I include only mature firms that have at least 5 year observations in the sample and without including firms that reincorporated during the sample period; this further mitigates the concern that the results are driven by self-selection. These results are also robust if I use bids for 30% or 100% of the shares instead of 50%. The results in columns 2, 4, and 6 of Table 10, which include state dummies and *Pill Statute*, are sensitive to some specifications. For example, for 30% bids, the coefficient on *Pill Statute* is negative and statistically significant, while the positive coefficient on Delaware is not statistically significant. However, for 100% bids, the coefficient on *Pill Statute* is not statistically significant and the coefficient on Delaware is. At any rate, as discussed above, as Delaware and Nevada are “bad controls”, and given the strength in all specifications of the negative relationship between *Pill Statute* and takeovers, there remains considerable evidence for the claim that the poison pill law partly accounts for the difference between Nevada and Delaware.

## 6.2 Probability of Litigation

### 6.2.1 Data and Research Design

In general, there is no available time-series database for cases litigated under state law that involve managers’ breaches of fiduciary duties. Recent studies however use data on securities class action litigation under federal law to estimate the probability of corporate litigation (Rogers and Stocken, 2005; Brochet and Srinivasan, 2013), including litigation under state law (Wilson, 2015). The rationale is that since many securities class actions also involve allegations of breaches of fiduciary duties, the probability of securities class action litigation can be used as a proxy for litigation that involves state corporate laws. Data on federal class action law suits is obtained from the Stanford Law School’s Securities Class Action Clearinghouse and is matched to the sample described in section 2. Studies of litigation probability typically use daily return data from CRSP to compute various predictors of litigation, including annual returns, standard deviation, the skewness of returns, and average turnover. The difficulty of applying these models to the present data is that many firms

incorporated in Nevada do not have data available on CRSP, and this limits the number of Nevada firms in the sample to a relatively narrow subset of larger firms (255 firms with an average of \$1.05 billion worth of assets as compared to 960 firms with an average of \$721.42 million in assets). Because size is positively correlated with the likelihood of litigation, this omission can significantly skew the results.

Therefore, in the first specification, I use a limited model, which is based on measures identified in prior research as determining selection effect into Nevada, such as size (measured by log of dollar volume of assets) and the percentage of institutional shareholding. I also add a dummy, *Takeover Bids*, which is equal to 1 if a firm receives a bid to acquire at least 30% of its shares in the current fiscal year or the previous two fiscal years; this controls for the fact that firms that receive a takeover bid are more likely to be sued. Finally, similar to most studies of litigation, I control for industries which have been identified as vulnerable to securities litigation. These include biotechnology, computer hardware, electronics, retailing, and computer software. The second specification includes the standard model with the limited sample of Nevada firms.

Table 11 presents the descriptive statistics. It is apparent that firms in Delaware face substantially more litigation than firms in Nevada. 11.43% of the firms in Delaware are subject at least once to litigation as compared to only 2.29% of Nevada firms. In fact, 75% of the lawsuits are against Delaware firms, a percentage that is larger than Delaware's share of the incorporation market. When looking at the industry level, we find that Delaware firms consist of a relatively high percentage of firms from industries which are vulnerable to litigation (40.31% of the firms), whereas a relatively small percentage of Nevada firms (26.98%) belong to these industries. This might suggest that the lower (higher) percentage of Nevada (Delaware) firms among firms which are subject to litigation is related to the lower (higher) presence of vulnerable industries in Nevada (Delaware) rather than to Nevada (Delaware) law. The regression results, however, do not suggest that this is the case.

Finally, I also control for the level of managerial liability protection offered by each state's laws by including a control for the *DIROFF* variable. *DIROFF* measures the extent to which states allow corporations to exempt managers from fiduciary duties, particularly the duty of loyalty, and whether such exemptions apply by default as opposed to requiring shareholder approval.<sup>38</sup> Nevada's score under this measure is the maximum of 12, whereas Delaware's score is 2. The goal is to see if any differences between Delaware and Nevada firms persist

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<sup>38</sup>For further detail, see Eldar & Magnolfi (2016).

when controlling for the substantive law of each state. To be sure, as discussed above, including a measure of the substance of the law and state dummies suffers from the problem of “bad controls” discussed above. Nonetheless, the results may be suggestive if *DIROFF* accounts for the difference between Delaware and Nevada.

### 6.2.2 Results

The results of the logit regression in Table 12 suggest that incorporation in Nevada is associated with lower litigation probability than in Delaware. The coefficient on the Delaware dummy is positive and statistically significant in all specifications. I first focus on columns 1-3, which do not control for *DIROFF*. The coefficient on the Nevada dummy is negative and statistically significant in the model without the Delaware incorporation dummy (column 1), but becomes statistically insignificant when controlling for Delaware incorporations (column 3). Nonetheless, the Wald statistic score indicates that we can reject the null hypothesis that it is larger or equal to the coefficient on Delaware at the 1% significance level. I further emphasize that the coefficients on the controls generate the expected signs. Thus, large firms, firms that have received a bid in recent years, and firms in vulnerable industries (except retailing) are more likely to be subject to litigation.

Unlike the takeover probability analysis, though, the results are slightly weaker when I focus the analysis on small firms only. For example, the difference between the Delaware and Nevada coefficients is not statistically significant when I include only small firms in the sample, possibly because the sample size is substantially smaller. However, Delaware incorporation is still highly correlated with a higher probability of litigation, further supporting the view that the shift to Nevada is driven by desire to avoid the litigious environment of Delaware.<sup>39</sup> Moreover, if instead of splitting the data, I include in the specification of Table 12 an interaction term between Nevada incorporation and dummy that equals one if the firm has less than \$50 million in assets, the coefficient on Nevada is largely zero (0.33 with a t-statistic of 0.14), while the coefficient on the interaction term is highly negative (-1.49 with a t-statistic of -2.66). This suggests that the association between Nevada incorporation and a lower probability of litigation is driven mainly by small firms.

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<sup>39</sup>In addition, the results for the sample of small firms is largely the same as the results for the sample of large firms; thus, the analysis in Table 12 is not driven by large firms, and presumably applies to small firms for which Nevada law seems to be value enhancing. In particular, the coefficient on Delaware in the sample of small firms with less than \$50 million in assets is 0.757 with a t-statistic of 3.23 and 0.86 with a t-statistic of 5.20 in the sample of large firms with \$50 million in assets or more.



In columns 4-7, I further examine the effect of liability protections on the probability of litigation by including the *DIROFF* variable. First, the probability of litigation is negatively correlated with *DIROFF*. Interestingly, the coefficient on the Nevada dummy is positive when including *DIROFF*, suggesting that but for the liability protection Nevada firms would be likely to be sued. Note also that in column 7, the Wald statistic indicates that we cannot reject the null hypothesis that the coefficient on the Nevada dummy is larger or equal to the coefficient on the Delaware dummy. We should treat this result with caution of course since liability under securities litigation is not protected by states' liability exemptions. However, it is suggestive that the channel through which Nevada law protects managers from liability is through its liability provisions.

These results are generally robust to including only mature firms with at least 5 years of observations and firms that did not undergo reincorporation in the sample period. Note, however, that the concern that the results are driven by self-selection of firms that are less likely to be sued is not particularly strong in this context. The reason is that Nevada firms tend to be more fragile financially than firms in other states and also experience a higher rate of financial restatements (Barzuza & Smith, 2014). Therefore, all things equal, Nevada would appear to attract firms that are more vulnerable to litigation.<sup>40</sup>

Finally, in Table 13, I also evaluate litigation probability models using standard models with CRSP data as well as vulnerable industries (see Rogers and Stocken, 2005; Brochet and Srinivasan, 2013), despite the fact mentioned above that this specification significantly reduces the number of Nevada firms in the sample. The coefficient on Nevada is positive but not statistically significant, whereas the coefficient on the Delaware dummy is positive and statistically significant. The coefficient on *DIROFF* in columns 4-7 is again negative and usually statistically significant. Interestingly, the Nevada effect is positive when controlling for *DIROFF*, suggesting again that without liability protection laws Nevada firms would be likely to face more lawsuits.

## 7 Conclusion

Conducting comprehensive tests of the relationship between Nevada corporate law and shareholder value, I find no evidence that it harms shareholders. In fact, the Tobin's Q

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<sup>40</sup>On the other hand, if Nevada nonetheless attracts firms with a lower litigation probability, then this suggests that Nevada laws are not lax in the sense that they shield managers from liability to the detriment of shareholder value.

regression and the event study of reincorporation into Nevada suggest that Nevada's pro-managerial system is conducive to the value of the firms that choose to incorporate in Nevada. These firms, which are often relatively small and managed by insiders, seem to benefit from the lower costs of corporate governance and shareholder monitoring through takeovers and litigation. These results demonstrate that strong shareholder monitoring and stringent fiduciary norms are not necessarily conducive to shareholder welfare.

To be sure, I do not argue that lax corporate laws are beneficial for all firms. Most firms would (and do in fact) benefit from incorporating in Delaware. But, while laws that facilitate takeovers may increase shareholder value, so might laws that allow firms to pursue long-term growth and avoid litigation depending on the characteristics of the firms and economic conditions.

The results thus cast doubt on the need for federal regulation of corporate law. If firms' incorporation choices benefit or at least do not harm their shareholders federal regulation may in fact be harmful to the extent that it imposes a legal regime that is inappropriate for particular firms. The system of regulatory competition in the U.S. allows for firms into opt into different regulatory regimes and each of these regimes may be conducive to enhancing shareholder value.

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## Appendix A

Variable Description		
Variable	Definition	Source
<b>Biotechnology</b>	A dummy variable for firms with SIC codes between 2833 and 2836	Compustat, SEC Analytics
<b>Computer Hardware</b>	A dummy variable for firms with SIC codes between 3570 and 3577	Compustat, SEC Analytics
<b>Computer Software</b>	A dummy variable for firms with SIC codes between 7371 and 7379	Compustat, SEC Analytics
<b>Capex Ratio</b>	The ratio of capital expenditures over total book assets	Compustat
<b>Delaware</b>	A dummy equal to 1 if a firm is incorporated in Delaware	SEC Edgar
<b>DIROFF</b>	An index that ranges from 0 to 12 that measures states' protection of directors and officers from monetary liability	Eldar & Magnolfi (2016)
<b>Electronics</b>	A dummy variables for firms with SIC codes between 3600 and 3674	Compustat, SEC Analytics
<b>Ind. Takeovers</b>	The number of 50% takeover bids in the industry in the previous year based on the Fama-French 49 industry classification	SDC
<b>Institutional Ownership</b>	The fraction of shares held by institutional shareholders sourced from 13F filings	Thomson Reuters
<b>Leverage</b>	The ratio of total liabilities over total book assets	Compustat
<b>Log(Cash)</b>	The natural log of cash and short-term investments to assets ratio.	Compustat
<b>Log(Mkvalt)</b>	The natural log of market value	Compustat
<b>Manager &gt; 15%</b>	a dummy equal to 1 if managers (both directors and officers) hold more than 15% of the stock of the company.	Thomson Reuters
<b>Managerial Ownership</b>	The fraction of shares held by directors or officers sourced from Forms 3,4 and 5	Thomson Reuters
<b>Nevada</b>	A dummy equal to 1 if a firm is incorporated in Nevada.	SEC Edgar
<b>Retail</b>	A dummy variable for firms with SIC codes between 5200 and 5961	
<b>R&amp;D Ratio</b>	The ratio of research and development expenditures over total book assets	Compustat
<b>ROA</b>	Return on assets	Compustat
<b>Post</b>	A dummy variable equal to 1 if the fiscal year starts on or after July 1 2001	Compustat
<b>Takeover Bids</b>	A dummy that equals 1 if the firm received a bid to acquire at least 30% of its shares in the current fiscal year or in the preceding two fiscal years	SDC
<b>Tobin's Q</b>	The ratio of the market value of assets to the book value of assets, where the market value is calculated as the sum of the book value of assets and the market value of common stock less the book value of common stock and deferred taxes	Compustat

## Appendix B

Table 1: **Descriptive Statistics**

Variable	Mean	Std. Dev.	25% perc.	Median	75% perc.
<b>Panel A - Total Sample (N=73,889)</b>					
Tobin's Q	2.218	1.69	1.159	1.599	2.551
Market Value (\$mil)	2,500.029	14,210.14	31.362	171.165	836.912
Assets (\$mil)	2,175.602	14,259.253	31.687	160.589	787.944
Sales (\$mil)	1,946.636	10,474.227	25.007	153.950	788.862
Leverage	0.58	0.564	0.298	0.498	0.694
R&D Ratio	0.07	0.149	0	0.003	0.076
Capex Ratio	0.057	0.068	0.016	0.034	0.069
Inst. Ownership (%)	40.235	32.629	7.21	36.976	69.631
Managerial Ownership (%)	5.052	10.832	0	0.929	4.487
<b>Panel B - Nevada Firms (N=3,231)</b>					
Tobin's Q	2.91	2.338	1.227	1.930	3.762
Market Value (\$mil)	561.378	2,601.642	6.118	23.454	109.200
Assets (\$mil)	547.758	2,098.589	4.952	16.792	96.872
Sales (\$mil)	449.095	1,800.893	1.572	12.086	102.588
Leverage	0.841	1.044	0.342	0.597	0.869
R&D Ratio	0.051	0.147	0	0	0.024
Capex Ratio	0.070	0.096	0.007	0.031	0.087
Inst. Ownership (%)	15.890	26.683	0	0.508	20.280
Managerial Ownership (%)	6.761	14.359	0	0.221	6.467
<b>Panel C - Delaware Firms (N=44,835)</b>					
Tobin's Q	2.245	1.69	1.173	1.631	2.613
Market Value (\$mil)	2482.38	11559.443	46.618	234.314	1,010.878
Assets (\$mil)	2218.284	10949.852	45.923	211.950	969.365
Sales (\$mil)	2033.794	10572.576	33.689	190.192	901.887
Leverage	0.578	0.544	0.297	0.503	0.700
R&D Ratio	0.081	0.162	0	0.008	0.096
Capex Ratio	0.055	0.066	0.015	0.033	0.067
Inst. Ownership (%)	44.114	32.685	11.974	43.148	73.844
Managerial Ownership (%)	4.410	9.767	0.000	0.841	3.757

Descriptive statistics for a sample of 9,917 public firms between 1994 and 2013 (6,293 Delaware firms and 697 Nevada firms). N denotes the number of firm year observations. Financial firms and utilities are excluded. Panel A presents data for the total sample and Panels B and C present data for firms incorporated in Nevada and Delaware respectively. All variables are described in Appendix A.



Table 2: Tobin's Q Regressions

	OLS Regression				Random Effects			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Nevada	0.504*** (7.64)	1.290*** (9.94)	0.791*** (9.04)	0.684*** (8.40)	0.569*** (7.13)	1.373*** (9.87)	0.714*** (7.75)	0.642*** (7.26)
Delaware	0.0781*** (3.16)	0.0734*** (2.98)	0.0752*** (3.05)	0.0756*** (3.07)	0.115*** (3.96)	0.107*** (3.68)	0.112*** (3.85)	0.113*** (3.90)
Log(Assets)	-0.110*** (-16.41)	-0.0992*** (-14.66)	-0.103*** (-15.26)	-0.104*** (-15.44)	-0.231*** (-29.92)	-0.217*** (-27.81)	-0.225*** (-29.05)	-0.228*** (-29.26)
Leverage	0.579*** (28.93)	0.563*** (27.88)	0.573*** (28.59)	0.576*** (28.80)	0.597*** (31.35)	0.586*** (30.35)	0.597*** (31.26)	0.597*** (31.33)
R&D Ratio	2.597*** (27.75)	2.630*** (28.05)	2.619*** (27.94)	2.615*** (27.91)	1.277*** (12.66)	1.308*** (12.94)	1.290*** (12.78)	1.285*** (12.73)
Capex Ratio	2.050*** (13.03)	2.090*** (13.33)	2.088*** (13.31)	2.074*** (13.21)	1.981*** (14.88)	1.989*** (15.01)	1.987*** (14.96)	1.983*** (14.91)
NV * Log(Assets)		-0.229*** (-7.64)				-0.276*** (-8.25)		
NV*(Assets>\$50m)			-0.848*** (-8.08)				-0.570*** (-5.14)	
NV*(Assets>\$100m)				-0.698*** (-6.29)				-0.431*** (-3.46)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Ind. dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.235	0.238	0.237	0.236	0.209	0.213	0.211	0.210
N	73,889	73,889	73,889	73,889	73,889	73,889	73,889	73,889

$t$  statistics in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

All variables not defined herein are defined in Appendix A. NV\*(Assets>\$50m) and NV\*(Assets>\$100m) are interaction dummy variables, and each equals 1 if a firm is incorporated in Nevada and has more than \$50 or \$100 million in assets, respectively. Each regression includes unreported year and two-digit industry fixed effects. T-statistics are based on robust standard errors and clustered by firm.

Table 3: Tobin's Q Regressions by Firm Size

	OLS Regression				Random Effects			
	(1) Assets > \$50m	(2) Assets ≤ \$50m	(3) Assets > \$100m	(4) Assets ≤ \$100m	(5) Assets > \$50m	(6) Assets ≤ \$50m	(7) Assets > \$100m	(8) Assets ≤ \$100m
Nevada	0.0906 (1.32)	0.505*** (6.04)	0.0726 (0.92)	0.482*** (6.18)	0.0286 (0.37)	0.641*** (7.10)	-0.0679 (-0.92)	0.613*** (7.12)
Delaware	0.0697*** (2.77)	0.231*** (5.19)	0.0545** (2.01)	0.197*** (5.23)	0.103*** (3.44)	0.199*** (4.39)	0.0862*** (2.65)	0.179*** (4.52)
Log(Assets)	0.0167** (2.03)	-0.499*** (-21.24)	0.0137 (1.44)	-0.380*** (-21.41)	-0.159*** (-16.38)	-0.499*** (-20.79)	-0.195*** (-16.83)	-0.411*** (-22.45)
Leverage	-0.342*** (-5.58)	0.628*** (31.26)	-0.329*** (-4.55)	0.617*** (31.32)	-0.0947* (-1.79)	0.641*** (31.86)	-0.0922 (-1.47)	0.634*** (32.03)
R&D Ratio	3.536*** (19.24)	2.108*** (20.02)	4.516*** (17.29)	2.130*** (21.42)	1.421*** (7.83)	1.182*** (10.70)	1.939*** (7.26)	1.188*** (11.42)
Capex Ratio	1.934*** (10.96)	2.612*** (10.38)	1.986*** (10.39)	2.409*** (10.94)	1.737*** (12.06)	2.218*** (10.13)	1.783*** (11.40)	2.032*** (10.62)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Ind. dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.180	0.292	0.183	0.274	0.133	0.280	0.128	0.262
N	50,595	23,294	42,694	31,194	50,595	23,294	42,694	31,194

*t* statistics in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

This table presents the results of Tobin's Q regressions where the sample is split into sub-samples of firms with more or less than \$50 or \$100 million. Columns 1 through 4 present results for OLS regressions and columns 5 through 8 present results for the random effects model. Tobin's Q is trimmed at the 5% level and all financial controls are winsorized at the 1% level. Each regression includes unreported year and two-digit industry fixed effects. T-statistics are based on robust standard errors and clustered by firm. All variables not defined herein are defined in Appendix A.

Table 4: **Tobin's Q - Matching Estimators**

	Model 1		Model 2		Model 3	
	Nevada (1)	Delaware (2)	Nevada (3)	Delaware (4)	Nevada (5)	Delaware (6)
ATE	-0.0882**	0.263***	0.0592	0.204***	-0.0554	0.0833***
<i>t</i> statistics	(-2.53)	(19.46)	(1.58)	(14.88)	(-0.87)	(5.86)
N	73,889	73,889	73,889	73,889	73,889	73,889
ATE <sub>T</sub>	0.162***	0.251***	0.358***	0.196***	0.373***	0.0825***
<i>t</i> statistics	(3.32)	(18.15)	(7.16)	(14.07)	(6.94)	(5.27)
N	73,889	73,889	73,889	73,889	73,889	73,889
Assets>\$50m	-0.235***	0.183***	-0.162***	0.151***	-0.221***	0.0916***
<i>t</i> statistics	(-5.50)	(13.32)	(-4.30)	(11.41)	(-3.22)	(6.93)
N	50,595	50,595	50,595	50,595	50,595	50,595
Assets<\$50m	0.322***	0.440***	0.469***	0.356***	0.314***	0.158***
<i>t</i> statistics	(5.33)	(14.25)	(7.00)	(11.55)	(3.33)	(5.20)
N	23,294	23,294	23,294	23,294	23,294	23,294
Assets>\$100m	-0.227***	0.147***	-0.170***	0.125***	-0.128	0.0874***
<i>t</i> statistics	(-4.82)	(10.21)	(-4.39)	(9.06)	(-1.57)	(6.47)
N	42,694	42,694	42,694	42,694	42,694	42,694
Assets<\$100m	0.176***	0.424***	0.297***	0.337***	0.244***	0.134***
<i>t</i> statistics	(3.39)	(16.80)	(5.05)	(13.46)	(2.74)	(5.38)
N	31,194	31,194	31,194	31,194	31,194	31,194

*t* statistics in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

This table presents the results of Tobin's Q regressions using matching estimators where the treatment effect is either Nevada or Delaware incorporation. Tobin's Q is trimmed at the 5% level. In Model 1, I match observations by asset size. In Model 2, I match observations by asset size, institutional shareholding and managerial ownership. In Model 3, I match observations by asset size, institutional shareholding and managerial ownership, year dummies, two-digit industry dummies, expenses on research and development, capital expenditure, and total liabilities. ATE denotes the average treatment effect. ATE<sub>T</sub> denotes the average treatment effect on the treated. The table also shows the ATE results for sub-samples of firms with more or less than \$50 or \$100 million in assets. Each observation is matched with at least one observation from the other treatment level. All estimates are bias adjusted when matching on more than one continuous variable (see Imbens & Rubin, 2015). T-statistics are based on robust standard errors.

Table 5: **Reincorporations into Nevada 1996-2013**

Event Window	All	Firms with Proxies	From Delaware	From Low Protection States	Insider $\geq$ 25%	Insiders $<$ 25%	Stock Exchange	OTC	No Financials / Utilities / Foreign
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<b>Panel A - All Reincorporations</b>									
(-1,1)	-0.0137	-0.0156	-0.00474	0.0181	-0.00680	-0.0285	0.00380	-0.0246	0.0228
<i>t</i> statistics	(-0.36)	(-0.35)	(-0.22)	(0.39)	(-0.11)	(-0.46)	(0.11)	(-0.43)	(0.59)
N	76	64	36	57	38	26	29	47	48
(0,3)	0.0111	0.00589	0.0251	0.0198	0.0113	-0.00279	-0.00684	0.0226	0.0186
<i>t</i> statistics	(0.31)	(0.14)	(1.01)	(0.44)	(0.18)	(-0.06)	(-0.17)	(0.42)	(0.45)
N	72	60	35	55	37	23	28	44	48
(-1,5)	0.0251	0.0133	0.0147	0.0289	-0.0225	0.0715	0.0361	0.0181	0.000941
<i>t</i> statistics	(0.59)	(0.27)	(0.44)	(0.54)	(-0.33)	(1.03)	(0.67)	(0.30)	(0.02)
N	75	63	35	57	39	24	29	46	49
<b>Panel B - Excluding Firms that Increase their Authorized Shares or undergo Reverse Stock Splits</b>									
(-1,1)	0.0458	0.0603	0.00820	0.114**	0.0987	0.0138	0.0181	0.0666	0.0733
<i>t</i> statistics	(1.04)	(1.18)	(0.36)	(2.18)	(1.48)	(0.17)	(0.44)	(0.93)	(1.33)
N	49	42	24	34	23	19	21	28	29
(0,3)	0.0777*	0.0805*	0.0354	0.110**	0.121*	0.0245	0.0338	0.113*	0.0703
<i>t</i> statistics	(2.00)	(1.82)	(1.03)	(2.22)	(1.95)	(0.41)	(0.73)	(1.90)	(1.32)
N	45	38	23	32	22	16	20	25	28
(-1,5)	0.115**	0.124**	0.0642*	0.156**	0.105	0.151	0.0490	0.169**	0.0607
<i>t</i> statistics	(2.42)	(2.27)	(2.05)	(2.51)	(1.53)	(1.65)	(0.68)	(2.67)	(1.12)
N	47	40	23	33	23	17	21	26	29
<i>t</i> statistics in parentheses. * $p < 0.10$ , ** $p < 0.05$ , *** $p < 0.01$									

This table presents the cumulative abnormal returns of firms reincorporating into Nevada between 1996 and 2013. The event date of each reincorporation is the date of the preliminary or definitive proxy statement, whichever was filed first. If no proxy was filed, I use the date of the first public disclosure that mentions the reincorporation. Cumulative abnormal returns are calculated using the Fama-French factor model with adjustment for “no trade” days following Maynes & Rumsey (1993). Panel A presents results for the total sample and Panel B presents results for the sample of firms that did not undergo a reverse stock split or increase their authorized shares on the event date. The results are further split into the following sub-samples: (a) firms that filed a preliminary or definitive proxy statement prior to the reincorporation (column 2); (b) firms that reincorporated from Delaware (column 3); (c) firms that reincorporated from states that do not allow companies to exempt managers from the duty of loyalty (column 4); (d) firms that have at least 25% managerial ownership (column 5); (e) firms that have less than 25% managerial ownership (column 6); (f) firms traded on a major stock exchange (column 7); (g) firms traded over the counter; (h) a sample which excludes financials, utilities and foreign firms (column 8).

Table 6: The 2001 Law Reform

Panel A - Short Intervals Around Event Dates				Panel B - Long Intervals Around Event Dates			
	(1)	(2)	(3)		(1)	(2)	(3)
	All	Unaffected	Affected		All	Unaffected	Affected
May 22, 2001 - Bill draft request is discussed in the Senate				April 23, 2001 - May 18, 2001			
(-1,1)	0.0104*	0.00772	0.0157*		0.00175	0.00146	0.00236
<i>t</i> statistics	(1.77)	(1.19)	(1.84)	<i>t</i> statistics	(0.74)	(0.56)	(0.68)
May 24, 2001 - Bill is introduced in the Senate				May 21, 2001 - June 5, 2001			
(0,1)	-0.0000371	0.00217	-0.00452		0.00398	0.00338	0.00519
<i>t</i> statistics	(-0.01)	(0.27)	(-0.43)	<i>t</i> statistics	(1.28)	(0.99)	(1.13)
May 29, 2001 - Bill passes in the Senate				June 6, 2001 - June 18, 2001			
(0,1)	-0.00210	-0.00391	0.00157		-0.00201	-0.00208	-0.00187
<i>t</i> statistics	(-0.29)	(-0.49)	(0.15)	<i>t</i> statistics	(-0.59)	(-0.55)	(-0.37)
June 4, 2001 - Bill passes in the Assembly				Sum over Event Intervals			
(-1,1)	-0.000750	0.00140	-0.00511		0.00372	0.00276	0.00568
<i>t</i> statistics	(-0.13)	(0.21)	(-0.59)	<i>t</i> statistics	(0.72)	(0.48)	(0.75)
June 15, 2001 - The law becomes effective				N			
(-1,1)	-0.000462	-0.00227	0.00321		106	71	35
<i>t</i> statistics	(-0.08)	(-0.35)	(0.37)				
Sum over Event Intervals							
	0.007051	0.00511	0.01085				
<i>t</i> statistics	(0.49)	(0.32)	(0.52)				
N	106	71	35				

*t* statistics in parentheses\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

This table presents the abnormal returns around key dates in the adoption of Nevada's 2001 law reform, which exempted managers from the duty of loyalty. Panel A shows results for short intervals around the main event dates. The event window is (-1,1) with respect to each event date, except for the event dates of May 24, 2001 and May 29, 2001 where I use the event window (0,1) to avoid overlaps with the former event dates (see section 5.1). Panel B shows results for longer intervals around the event dates. Column 2 of each of the panels presents results for unaffected firms that exempted their directors and officers from liability to the full extent permitted under Nevada law prior to the law reform. Column 3 of each of the panels presents results for affected firms that did not exempt their directors or officers to the full extent before the law reform.

Table 7: Tobin's Q and the 2001 Law Reform

	OLS			Random Effects		
	All firms (1)	Mature Firms (2)	Older Firms (3)	All firms (4)	Mature Firms (5)	Older Firms (6)
Nevada	0.279*** (3.39)	0.219** (2.35)	0.289*** (2.80)	0.514*** (5.04)	0.515*** (4.61)	0.460*** (3.47)
Delaware	0.0791*** (3.20)	0.0823*** (2.92)	0.0586** (2.01)	0.116*** (3.98)	0.187*** (6.08)	0.0657* (1.88)
Post	-0.106** (-2.19)	-0.0906* (-1.81)	-0.162*** (-3.25)	-0.120*** (-3.19)	-0.113*** (-2.85)	-0.148*** (-3.81)
NV $\times$ Post	0.339*** (3.46)	0.309*** (2.86)	0.199* (1.73)	0.0841 (0.90)	0.0525 (0.52)	0.0141 (0.14)
Log(Assets)	-0.109*** (-16.26)	-0.0934*** (-12.55)	-0.0841*** (-10.82)	-0.231*** (-29.88)	-0.205*** (-24.19)	-0.194*** (-21.57)
Leverage	0.578*** (28.86)	0.559*** (22.69)	0.588*** (23.19)	0.597*** (31.35)	0.605*** (27.26)	0.616*** (26.56)
R&D Ratio	2.601*** (27.80)	2.755*** (25.20)	2.861*** (24.64)	1.280*** (12.69)	1.383*** (12.00)	1.457*** (11.78)
Capex Ratio	2.047*** (13.03)	1.965*** (10.67)	2.107*** (10.24)	1.980*** (14.87)	2.014*** (13.43)	2.204*** (12.89)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Ind. dummies	Yes	Yes	Yes	Yes	Yes	Yes
$R^2$	0.235	0.230	0.235	0.209	0.206	0.211
N	73,889	61,327	55,636	73,889	61,327	55,636

$t$  statistics in parentheses. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

This table presents the results of Tobin's Q regressions. Columns 1 through 3 present results for OLS regressions and columns 4 through 7 present results for the random effects model. Columns 2 and 5 present the results for a sample of "mature" firms that have at least five firm year observations and did not reincorporate from one state to another in the sample period. Columns 3 and 6 present results for "old" firms that have at least one year observation prior to and after the 2001 law reform. Tobin's Q is trimmed at the 5% level and all financial controls are winsorized at the 1% level. Each regression includes unreported year and two-digit industry fixed effects. T-statistics are based on robust standard errors and clustered by firm. All variables not defined herein are defined in Appendix A.

Table 8: **Descriptive Statistics of Takeover and Bids - 1995-2013**

	Sample		Delaware Firms		Nevada Firms	
	#	%	#	%	#	%
<b>Panel A - Number and Percentage of Takeovers and Bids out of the Total Sample</b>						
Completed Takeovers	1,162 (1,088)	1.81% (12.89%)	790 (741)	2.08% (14.16%)	33 (33)	1.01% (5.29%)
Takeover Bids	2,238 (1,893)	3.46% (22.42%)	1,477 (1,255)	3.89% (23.98%)	90 (70)	2.76% (11.22%)
Total Sample	64,376 (8,443)		38,058 (5,233)		3,255 (624)	
<b>Panel B - Number and Percentage of Completed Takeovers and Failed Bids out of the Number of Bids</b>						
Completed Takeovers	1,162 (1,088)	51.92% (57.47%)	790 (741)	53.49% (59.04%)	33 (33)	36.67% (47.14%)
Failed Bids	1,076 (942)	48.07% (49.76%)	687 (610)	46.51% (48.61%)	57 (45)	63.33% (64.29%)
Takeover Bids	2,238 (1,893)		1,477 (1,255)		90 (70)	

This table presents descriptive statistics for takeover bids, completed takeovers and failed bids in which the bidder acquires at least 50% of the firm's equity. Panel A presents the number of firm year observations in which there was a completed takeover and/or a takeover bid, and the percentage of such observations out of the total sample. The corresponding number of firms is presented in parentheses. Panel B presents the number of firm year observations in which there was a completed takeover or a failed bid, and the percentage of such observations out of the total number of takeover bids. The sample in both panels is divided into firms incorporated in Delaware and firms incorporated in Nevada.

Table 9: Takeover Probability - 1995-2013

	Probability of Receiving a Takeover Bid			Probability of Completed Takeover			Conditional Probability of Completed Takeover		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Nevada	-0.0632 (-0.48)		0.131 (0.96)	-0.502*** (-2.77)		-0.250 (-1.33)	-0.736*** (-3.20)		-0.621*** (-2.59)
Delaware		0.294*** (5.84)	0.308*** (5.93)		0.421*** (6.28)	0.397*** (5.76)		0.244** (2.53)	0.174* (1.73)
Tobin's Q	-0.0406*** (-3.38)	-0.0388*** (-3.33)	-0.0390*** (-3.32)	-0.0327*** (-2.98)	-0.0311*** (-2.91)	-0.0309*** (-2.90)	-0.0136 (-1.08)	-0.0142 (-1.10)	-0.0132 (-1.04)
ln(Mkvalt)	0.00762 (0.47)	0.00198 (0.12)	0.00216 (0.13)	0.00775 (0.36)	0.000854 (0.04)	0.000594 (0.03)	0.00276 (0.10)	-0.00331 (-0.12)	-0.00185 (-0.07)
Log(Cash)	-0.312* (-1.92)	-0.375** (-2.32)	-0.374** (-2.31)	-0.576*** (-2.77)	-0.647*** (-3.13)	-0.649*** (-3.13)	-0.515 (-1.60)	-0.498 (-1.54)	-0.538* (-1.67)
Leverage	0.122*** (5.53)	0.115*** (5.30)	0.115*** (5.28)	0.136*** (5.84)	0.127*** (5.54)	0.128*** (5.56)	0.170** (2.43)	0.173** (2.45)	0.165** (2.37)
ROA	0.0364 (1.38)	0.0380 (1.41)	0.0406 (1.51)	0.0268 (0.84)	0.0352 (1.08)	0.0311 (0.95)	-0.0680 (-0.86)	-0.0481 (-0.59)	-0.0689 (-0.87)
Ind. Takeovers	0.0222*** (4.02)	0.0206*** (3.73)	0.0206*** (3.73)	0.0144* (1.94)	0.0124* (1.66)	0.0124* (1.66)	-0.0114 (-1.04)	-0.0134 (-1.21)	-0.0126 (-1.15)
Inst. Ownership	0.109 (0.99)	0.0809 (0.75)	0.0882 (0.81)	-0.0686 (-0.45)	-0.0817 (-0.54)	-0.0927 (-0.61)	-0.285 (-1.49)	-0.257 (-1.35)	-0.290 (-1.52)
Manager > 15%	0.291* (1.79)	0.298* (1.84)	0.300* (1.85)	-0.144 (-0.55)	-0.130 (-0.50)	-0.133 (-0.51)	-0.690** (-2.08)	-0.690** (-2.08)	-0.699** (-2.11)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
DE $\geq$ NV			1.75			12.53***			11.72
- p value			(0.37)			(0.01)			(0.01)
Pseudo R <sup>2</sup>	0.0125	0.0146	0.0147	0.0149	0.0179	0.0181	0.0267	0.0255	0.0277
N	64,376	64,376	64,376	64,376	64,376	64,376	2,238	2,238	2,238

*t* statistics in parentheses\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

The dependent variable in columns 1-3 is a dummy equal to 1 if the company received a bid to acquire at least 50% of the equity of the firm. The dependent variable in columns 4-6 is a dummy equal to 1 if the company is the target of a 50% completed takeover. The dependent variable in columns 7-9 is a dummy equal to 1 if the company received a bid for 50% of the shares and the takeover was completed. Tobin's Q, ROA, and Log(Cash) are all industry adjusted and (together with Log(Mkvalt)) winsorized at the 1% level. All financial variables are measured at the end of the fiscal year previous to the takeover event. DE  $\geq$  NV denotes the Wald Statistic testing the null hypothesis that the coefficient on Delaware is larger or equal to the coefficient on Nevada. All regressions include unreported year fixed effects. T-statistics are based on robust standard errors. All variables not defined herein are defined in Appendix A.



Table 10: **Takeover Probability and Poison Pill Statutes - 1995-2013**

	Probability of Receiving a Takeover Bid		Probability of Completed Takeover		Conditional Probability of Completed Takeover	
	(1)	(2)	(3)	(4)	(5)	(6)
Pill Statute	-0.294*** (-5.59)	-0.138 (-1.28)	-0.457*** (-6.37)	-0.264* (-1.96)	-0.307*** (-3.01)	-0.248 (-1.20)
Nevada		0.160 (1.15)		-0.189 (-1.00)		-0.568** (-2.33)
Delaware		0.199* (1.96)		0.193 (1.55)		-0.0215 (-0.11)
Tobin's Q	-0.0393*** (-3.35)	-0.0391*** (-3.32)	-0.0315*** (-2.93)	-0.0310*** (-2.90)	-0.0136 (-1.05)	-0.0128 (-1.01)
ln(Mkvalt)	0.00397 (0.25)	0.00257 (0.16)	0.00336 (0.16)	0.00136 (0.06)	-0.00369 (-0.13)	-0.00215 (-0.08)
ln(Cash)	-0.373** (-2.30)	-0.378** (-2.33)	-0.651*** (-3.13)	-0.657*** (-3.16)	-0.500 (-1.55)	-0.536* (-1.67)
Leverage	0.117*** (5.38)	0.115*** (5.29)	0.129*** (5.62)	0.128*** (5.57)	0.169** (2.40)	0.163** (2.34)
ROA	0.0368 (1.37)	0.0407 (1.51)	0.0338 (1.04)	0.0313 (0.96)	-0.0493 (-0.61)	-0.0679 (-0.86)
Ind. Takeovers	0.0210*** (3.80)	0.0206*** (3.74)	0.0129* (1.73)	0.0125* (1.67)	-0.0131 (-1.19)	-0.0124 (-1.12)
Inst. Ownership	0.0894 (0.82)	0.0907 (0.84)	-0.0719 (-0.47)	-0.0878 (-0.57)	-0.253 (-1.33)	-0.284 (-1.49)
Manager > 15%	0.295* (1.82)	0.300* (1.85)	-0.134 (-0.51)	-0.133 (-0.51)	-0.702** (-2.11)	-0.707** (-2.12)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
DE $\geq$ NV		0.05		2.58		3.09
- <i>p</i> value		0.78		0.28		0.22
<i>Pseudo R</i> <sup>2</sup>	0.0181	0.0184	0.0144	0.0148	0.0264	0.0283
N	64,376	64,376	64,376	64,376	2,238	2,238

*t* statistics in parentheses.\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

The dependent variable in columns 1 and 2 is a dummy equal to 1 if the company received a bid to acquire at least 50% of the equity of the firm. The dependent variable in columns 3 and 4 is a dummy equal to 1 if the company is the target of a 50% completed takeover. The dependent variable in columns 5 and 6 is a dummy equal to 1 if the company received a bid for 50% of the shares and the takeover was completed. Tobin's Q, ROA, and Log(Cash) are all industry adjusted and (together with Log(Mkvalt)) winsorized at the 1% level. All financial variables are measured at the end of the fiscal year previous to the takeover event. DE  $\geq$  NV denotes the Wald Statistic testing the null hypothesis that the coefficient on Delaware is larger or equal to the coefficient on Nevada. T-statistics are based on robust standard errors. All variables not defined herein are defined in Appendix A.

Table 11: Descriptive Statistics of Securities Class Action Suits - 1996-2013

	Sample		Delaware Firms		Nevada Firms	
	#	%	#	%	#	%
<b>Panel A - Litigation</b>						
Class Action Suits	1,199 (1,008)	1.43% (9.39%)	910 (768)	1.82% (11.43%)	22 (22)	0.44% (2.29%)
<b>Panel B - Vulnerable Industries</b>						
Biotechnology	5,915 (793)	7.07% (7.39%)	4,420 (616)	8.84% (9.17%)	307 (60)	6.17% (6.25%)
Computer Hardware	2,266 (342)	2.71% (3.19%)	1,432 (216)	2.87% (3.22%)	77 (16)	1.55% (1.67%)
Electronics	6,371 (833)	7.62% (7.76%)	4,206 (554)	8.42% (8.25%)	198 (45)	3.98% (4.69%)
Retailing	6,021 (833)	7.20% (7.76%)	3,359 (485)	6.72% (7.22%)	256 (59)	5.15% (6.15%)
Computer Software	7,083 (1,212)	8.47% (11.29%)	4,177 (837)	8.36% (12.46%)	327 (79)	6.57% (8.23%)
Total Vulnerable Ind.	27,656 (4,013)	33.06% (37.40%)	17,594 (2,708)	35.20% (40.31%)	1,165 (259)	23.42% (26.98%)
<b>Panel C - Total Sample</b>						
Total observations	83,650 (10,731)		49,978 (6,718)		4,974 (960)	

This table presents descriptive statistics for the number of firm year observations in which a securities class action lawsuit is filed between 1996 and 2013, the number of firms sued in such lawsuits (in parentheses), and the percentages out of the total sample of observations and firms respectively. Information on securities class action lawsuits is obtained from the Stanford Securities Class Action Clearinghouse. Panel A presents data on the total number of securities class action lawsuits. Panel B presents data on class action lawsuits for each of the industries identified as vulnerable to litigation (see Rogers and Stocken, 2005): Biotechnology, Computer Hardware, Electronics, Retailing, and Computer Software. Panel C reports the total observations in the sample. The sample in all panels is divided into firms incorporated in Delaware and firms incorporated in Nevada.

Table 12: **Litigation Risk - 1996-2013**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Nevada	-0.443** (-2.18)		-0.132 (-0.63)		0.508* (1.86)		0.290 (1.01)
Delaware		0.458*** (6.19)	0.447*** (5.86)			0.370*** (4.25)	0.357*** (4.08)
DIROFF				-0.0929*** (-4.69)	-0.119*** (-4.76)	-0.0423* (-1.86)	-0.0599** (-2.03)
Takeover Bids	0.325*** (3.39)	0.289*** (3.01)	0.290*** (3.02)	0.311*** (3.24)	0.307*** (3.20)	0.289*** (3.02)	0.288*** (3.00)
Log (\$ Assets)	0.234*** (15.99)	0.234*** (15.77)	0.233*** (15.65)	0.235*** (16.35)	0.237*** (16.49)	0.233*** (15.83)	0.235*** (15.88)
Institutional Shareholding	0.614*** (5.71)	0.566*** (5.28)	0.564*** (5.27)	0.604*** (5.66)	0.609*** (5.72)	0.567*** (5.30)	0.571*** (5.35)
Biotechnology	1.065*** (11.18)	1.015*** (10.37)	1.014*** (10.37)	1.036*** (10.83)	1.033*** (10.78)	1.010*** (10.36)	1.009*** (10.34)
Computer Hardware	1.113*** (8.04)	1.104*** (8.00)	1.103*** (7.98)	1.063*** (7.70)	1.056*** (7.66)	1.084*** (7.86)	1.080*** (7.83)
Electronics	0.792*** (7.91)	0.768*** (7.61)	0.767*** (7.61)	0.759*** (7.58)	0.756*** (7.54)	0.757*** (7.53)	0.756*** (7.51)
Retailing	0.0832 (0.69)	0.112 (0.93)	0.110 (0.91)	0.0814 (0.67)	0.0840 (0.70)	0.105 (0.87)	0.106 (0.88)
Computer Software	1.118*** (12.17)	1.078*** (11.77)	1.077*** (11.76)	1.100*** (12.06)	1.099*** (12.07)	1.075*** (11.77)	1.076*** (11.78)
DE $\geq$ NV			8.04***				0.04
- $p$ value			0.03				0.78
<i>Pseudo R</i> <sup>2</sup>	0.0620	0.0654	0.0654	0.0639	0.0641	0.0657	0.0658
N	83,650	83,650	83,650		83,650	83,650	83,650

*t* statistics in parentheses.\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

The dependent variable is a dummy equal to 1 if the company was sued in a federal class action lawsuit as recorded by Stanford Law School's Securities Class Action Clearinghouse. DE  $\geq$  NV denotes the Wald Statistic testing the null hypothesis that the coefficient on Delaware is larger or equal to the coefficient on Nevada. T-statistics are based on robust standard errors. All variables not defined herein are defined in Appendix A.

Table 13: Litigation Risk - 1996-2013

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Nevada	0.0195 (0.10)		0.153 (0.72)			0.534** (1.97)	0.476* (1.72)
Delaware		0.173** (2.30)	0.184** (2.35)		0.131 (1.46)		0.112 (1.26)
DIROFF				-0.0393** (-1.98)	-0.0211 (-0.89)	-0.0658*** (-2.66)	-0.0477* (-1.67)
Returns	-0.384*** (-5.58)	-0.382*** (-5.56)	-0.382*** (-5.56)	-0.384*** (-5.58)	-0.383*** (-5.56)	-0.384*** (-5.58)	-0.383*** (-5.57)
Stan. Dev.	14.91*** (4.42)	14.88*** (4.41)	14.81*** (4.39)	14.93*** (4.42)	14.89*** (4.41)	14.73*** (4.35)	14.72*** (4.35)
Skewness	-0.351*** (-7.07)	-0.351*** (-7.07)	-0.351*** (-7.07)	-0.351*** (-7.06)	-0.351*** (-7.07)	-0.350*** (-7.05)	-0.351*** (-7.06)
Min. Return	-2.475*** (-4.73)	-2.450*** (-4.68)	-2.455*** (-4.69)	-2.459*** (-4.70)	-2.448*** (-4.67)	-2.471*** (-4.72)	-2.460*** (-4.69)
Beta	0.171*** (3.49)	0.168*** (3.42)	0.168*** (3.43)	0.167*** (3.42)	0.166*** (3.41)	0.167*** (3.43)	0.167*** (3.41)
ln(Mkvalt)	0.408*** (20.01)	0.405*** (19.54)	0.405*** (19.54)	0.408*** (20.02)	0.406*** (19.59)	0.409*** (20.10)	0.407*** (19.69)
Turnover	0.0394*** (10.82)	0.0388*** (10.65)	0.0387*** (10.63)	0.0392*** (10.77)	0.0388*** (10.66)	0.0390*** (10.72)	0.0387*** (10.63)
Biotechnology	0.409*** (3.68)	0.390*** (3.45)	0.390*** (3.46)	0.393*** (3.52)	0.386*** (3.43)	0.390*** (3.49)	0.384*** (3.41)
Computer Hardware	0.248 (1.58)	0.247 (1.57)	0.250 (1.59)	0.224 (1.43)	0.235 (1.49)	0.218 (1.39)	0.229 (1.45)
Electronics	0.0693 (0.63)	0.0636 (0.58)	0.0663 (0.60)	0.0521 (0.47)	0.0562 (0.51)	0.0510 (0.46)	0.0548 (0.50)
Retailing	0.0314 (0.26)	0.0443 (0.37)	0.0469 (0.39)	0.0283 (0.23)	0.0398 (0.33)	0.0320 (0.26)	0.0416 (0.34)
Computer Software	0.408*** (4.15)	0.395*** (4.02)	0.396*** (4.04)	0.398*** (4.05)	0.393*** (4.00)	0.398*** (4.06)	0.394*** (4.01)
DE $\geq$ NV			0.02				1.48
- $p$ value			0.80				0.98
<i>Pseudo R</i> <sup>2</sup>	0.174	0.175	0.175	0.174	0.175	0.175	0.175
N	60,689	60,689	60,689	60,689	60,689	60,689	60,689

$t$  statistics in parentheses.\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

The dependent variable is a dummy equal to 1 if the company was sued in a federal class action lawsuit as recorded by Stanford Law School's Securities Class Action Clearinghouse. DE  $\geq$  NV denotes the Wald Statistic testing the null hypothesis that the coefficient on Delaware is larger or equal to the coefficient on Nevada.  $T$ -statistics are based on robust standard errors. Log(Mkvalt) in this table is the natural log of the average market capitalization based on CRSP data. Returns is the cumulative buy-and-hold return. Stan. Dev. is the standard deviation of daily returns. Skewness is the skewness of daily returns. Min Return is the minimum daily return. Beta is the slope coefficient from a regression of daily returns on the CRSP equal-weighted Index. Turnover is the average daily trading volume divided by the average shares outstanding. All other variables are defined in Appendix A.