

What Happens in Nevada?

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This paper finds that Nevada, the only state that competes with Delaware for out-of-state incorporations, attracts firms that have a large and significant likelihood of reporting financial results that later require restatement. Compared with Delaware and other states, restatement likelihoods for Nevada-incorporated firms are nearly double on an unconditional basis, and 40% higher when controlling for firm-level characteristics. Our results suggest that Nevada corporate law attracts a certain class of firms that are prone to financial reporting failures. To the extent that such reporting failures proxy for higher agency costs, our findings indicate that firms may self-select a legal system that matches their desirable level of private-benefit consumption, and that Nevada competes to attract firms with higher agency costs.

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1. Introduction

One of the central debates among corporate law scholars is whether the U.S. system of state-level corporate law is socially efficient relative to a legal system that governs corporations at the national level. The debate, now spanning at least 30 years if not longer, relates to whether state-level competition leads to a race to the “bottom” (Cary (1974) Bebchuk (1992) Bebchuk & Ferrell (1999)) or “top” (Easterboork & Fischell (1991), Romano (1985, 1993, 2001) Winter (1977)) in terms of how corporate law protects firm shareholders. Because Delaware attracts more than half of all publicly traded firms in the United States, inferences related to state competition have always been drawn by comparing Delaware to other states.

This paper takes a novel tack by examining incorporations in another state that competes with Delaware for incorporations: Nevada. With 8.6% of all public incorporations by firms in states outside of their headquarter-state, Nevada is the only state beyond Delaware that attracts a significant number of out-of-state incorporations (see Table I). Nevada is currently the corporate home to 350 publicly traded companies. Promotions for the state make no secret of Nevada’s desire to compete with Delaware for out-of-state incorporations. Recent web-based advertisements for Nevada incorporation include tag-lines such as “The Expert’s Domestic Haven of Choice”, “You Can Live Anywhere and Still Incorporate In Tax Free, Lawsuit Proof, Private Nevada”, “Why Nevada?”, and “Control Everything and Own Nothing”.¹ Meanwhile, the website for the Nevada Secretary of State states that the Nevada business court that “developed on the

¹ See <http://www.nevada123.com/>, <http://www.nchinc.com/>, and <http://www.val-u-corp.com/whynev.html>, <http://www.nevada123.com/>, respectively.

Delaware model” and “minimizes the time, cost and risks of commercial litigation” as a reason to incorporate in Nevada.²

We use the popularity of Nevada incorporations to investigate cross-state variation in corporate disclosure quality. In particular, we focus on the frequency that companies incorporated within a given state are required to “restate” earlier financial disclosures that are found later to be incorrect. Accounting restatements are generally considered bad news. Restatements result in a significant negative market stock price reaction (Coffee (2005)), reduce the credibility of the reporting company (Anderson and Yohn (2002), and tend to be associated with weak corporate control (Baber, Kand and Liang (2006)). They are frequently preceded by balance sheet bloats (Ettredge, Scholz Smith and Sun 2010) and more common in firms that rank low on the different governance indices (Kedia and Philippon 2010). The evidence suggests that restatements could be an indirect measure of agency costs associated with the ability for company insiders to consume private benefits of control. Our maintained hypothesis is that insiders that extract higher private benefits are more likely to report incorrect revenues and therefore are more prone for restating.

Nevada competes with Delaware by adopting the efficiency of the Delaware courts, while advertising a stance that is more favorable to management and inside stakeholders. For instance, when a federal court issued a ruling suggesting Nevada courts follow Delaware standards, the Nevada legislature passed a law replacing most of Delaware standards with the business judgment rule.³ Nevada was the first to release its directors from liability for breach of duties of care and its law remains more protective of directors than Delaware 102(b)(7). Moreover, the default law in Nevada releases

² See <http://nvsos.gov/index.aspx?page=152>

³ *ITT V. Hilton Hotels*, 978 F. Supp. 1342, 1347 (D. Nev. 1997); NEV. REV. STAT. ANN. § 78.139 (West 2008). For a more extensive Nevada legislative history ,see section 2 below.

directors from liability, while Delaware law requires firms to opt into this protection.

Finally, directors and officers can be released from liability even if they acted in bad faith as long as there was not intentional misconduct, fraud or known violations of the law.⁴

Since Delaware and Nevada are both destinations for firms that choose to leave their home state, and because Nevada appears to provide greater protections for managers and insiders against intrusions by outside stockholders, comparing Nevada firms to Delaware firms may shed new light on the dynamics of the market for corporate law. In particular, we search for evidence that Nevada attracts firms that are more likely to report accounting results that are later restated.

There are two reasons why Nevada firms will be more likely to restate accounting results. First, we expect Nevada law to attract firms with larger private benefits. Insiders that extract high private benefits would look for rules that protect them. Second, if Nevada law allows insiders to extract more private benefits, they as a result may have more incentives to misreport and therefore will have to restate more frequently.

Figure 1 provides a preview of our results. It graphs the annual number restatements as a ratio of total public company incorporations for Nevada, Delaware, and all other states for the years 2000 through 2008. The figure shows that Nevada restatement frequencies were above Delaware and other states over the entire sample period. More pertinently, restatements in Nevada grew enormously over the period, peaking at nearly 30% of all Nevada public corporations during 2006, before dropping

⁴ See NRS 78.037, NRA 78.751. See also <http://www.nvinc.com/nservice12.htm>; <http://www.nvinc.com/WhereToFormLLC.htm>. Nevada uses similar strategy in its attempts to attract close corporations offering a law that makes it more difficult for claimants to “pierce the corporate veil” in lawsuits against corporate insiders. The three conditions that the plaintiff must establish are: “1. The corporation must be influenced and governed by the person asserted to be the alter ego, 2. There must be such unity of interest and ownership that one is inseparable from the other; and 3. The facts must be such that adherence to the corporate fiction of a separate entity would, under the circumstances, sanction fraud or promote injustice.” (*Why Incorporate in Nevada*, <http://www.nvinc.com/nservice12.htm>.)

down to a rate of 10% per year by 2008. By contrast, Delaware restatement frequencies remain in the range of other states throughout the period. Restatements in the non-Nevada states also rise during the sample period before dropping back off, but the frequencies are about half of what is observed in Nevada.⁵

To examine the robustness of the findings in Figure 1, we first compare the types of public firms incorporating in Nevada to those that incorporate in Delaware and in other states. We find that Nevada firms tend to be much smaller and less profitable than Delaware firms, although potential growth opportunities – as measured by the ratio of the market value to book value of assets – tend to be much larger in Nevada firms. Nevada firms are also relatively young: the median Nevada firm is one year younger than the median Delaware firm and a full three years younger than the median across all states. Clearly, Nevada firms are of a different type than those that incorporate in Delaware and other states.

We next examine firm-level restatement behavior as a function of state-of-incorporation, holding constant a variety of firm-level characteristics and by controlling for industry and year fixed effects. After controlling for these effects, we find that Nevada firms are 30 to 40% more likely to restate their financials than other states. Delaware restatement patterns, on the other hand, are not statistically distinguishable from the other non-Nevada states.

The sample period we examine is likely too short to say anything definitive about the impact of the passage of Sarbanes Oxley (SOX) on restatement frequencies, both at the national level and at the state level in Nevada. While Figure 1 shows a large run-up

⁵ Plumlee and Yohn (2008) document a rise in aggregate restatements over the 2002-2006 period, and attribute the rise to an increase in the complexity of audit rules, among other things. However, the Plumlee and Yohn (2008) dataset ends too early to observe the post-2006 decline present in Figure 1.

in restatements following the passage of SOX, particularly in Nevada, the figure also exhibits a significant decline in restatements after 2006. While this effect may reflect a large “bulge” in restatements as companies adjusted to the new disclosure environment, the effect may also be explained as a pro-cyclical effect related to the run up in stock prices and access to easy credit during this period. According to this latter explanation, companies misreport financials more frequently in an effort to keep the momentum in stock prices. A proper answer to this question will require restatement data through another credit cycle, which is currently unavailable using published sorts for restatement frequency.

Currently, we are examining the results on Nevada along two further dimensions. First, to determine causality in the “Nevada effect”, we are setting up regressions of firm fixed effect around firms that reincorporate in Nevada versus other states. We suspect that moving the state of incorporation to Nevada does not cause an increase in restatements. Rather, firms with higher agency costs that have a tendency for restatements select Nevada as a safe place to incorporate. Our firm fixed effect regressions will allow us to either confirm or reject these educated guesses.

Second, our goal is to come closer to saying something about whether Nevada incorporation is actually “bad” for the average shareholder in a Nevada-incorporated company. To do this, we will examine stock price reactions to restatement announcements as a function of state of incorporation. Other things being equal, we suspect that stock price reactions to Nevada restatements are less negative than average. In equilibrium, Nevada shareholders should expect restatements more often and stock prices should reflect this restatement discount in advance. A larger negative stock price

reaction for Nevada firms would indicate that (a) investors are not properly discounting Nevada-firm prices to reflect the poor quality of disclosures, or (b) the restatements themselves are bigger negative surprises than in other states. This similar line of thinking can also guide long-term performance studies of Nevada firms relative to firms in other states.

Overall, our results shed new light on state-level competition for incorporations. As Kahan and Kamar (2002) and Bebchuk and Hamdani (2002) document, there are serious barriers to entry in the market for corporate law. Our results explain why Nevada, nevertheless, attempts to compete with Delaware. In fact it does not compete for the same incorporations. Nevada targets a niche of firms with higher agency costs.

Our results also provide insight into agency costs within a firm can affect its choice of law. Past research has noted that heterogeneity across firms will affect their preferences for choice of law. For instance, firms differ in how many defensive tactics are included in their corporate charters in an IPOs (Daines and Klausner) and how firms vary in measures of corporate governance quality (Gompers, Ishii, and Metrick (2002)). These results suggest that firms with higher agency costs choose stronger managers protection.

Our results are also related to the literature on the relationship between law and firm performance. Asking whether the law matters for corporate governance and performance this literature has focused on finding casual relationship between the law and firm value, ownership structure, and other measures of performance (LLSV (1997, 1998, 1999)). This relationship could also be a reversed one in the sense that firm structure and performance may create certain lobbying advantages and affect the law (e.g. Roe (1994)). This paper suggests a third form of relationship between the law and firm

performance, that is that if given the option firms with weak internal constraints choose to be governed by weak legal constraints.

The rest of this incomplete paper proceeds as follows: Section 2 provides more theoretical background for our paper and reviews related literature. Section 3 describes the data and presents the results. Section 4 concludes.

2. Background and literature review

For many years, the literature has debated the desirability of the U.S. corporate legal system allowing companies to choose their state of incorporation and therefore the corporate law that applies to them. In its inception the debate has assumed that competition exists across states. The debated question was where its heading – to the top, producing efficient corporate law (Easterboork & Fischell (1991), Romano (1985, 1993, 2001) Winter (1977)) or to the bottom producing law that benefits managers and the expense of shareholders (Cary (1974) Bebchuk (1992) Bebchuk & Ferrell (1999)). More recent work has argued that Delaware does not face real competition from other states (Bebchuk & Hamdani (2002) Kahan & Kamar (2002)).

An influential empirical work found that firms in Delaware have higher Tobin's Q than firms in other states (Daines (2001)), arguably supporting a superiority of Delaware legal regime. Tobin's Q of Delaware firms' fluctuates significantly during the years, however, and may reflect factors other than Delaware law. Second, Subramanian has shown that this effect is decreasing (Subramanian (2004)). Finally, most of the firms that do not incorporate in Delaware incorporate in their home state (Daines (2002) Bebchuk

and Cohen (2002)). The decision to incorporate in the home state may be related to different factors such as whether or not the company is using a local law firm.

Other empirical works have investigated the influence of specific rules and courts quality on firms' choices. Bebchuk and Cohen (2002) and Subramanian (2002) found that states with weak antitakeover statutes lose more firms to Delaware than states with weak antitakeover statutes. Daines has found that antitakeover statutes do not matter significantly for IPO's choice of state of incorporation. Kahan (2006) found that firms are more likely to incorporate in states with high judicial quality and high flexibility but are not influenced by antitakeover statutes. A recent work has shown that there is a mean preference for antitakeover statutes but that this mean preference is being reversed among firms with large institutional holdings and among venture capital backed firms (Cohen 2009).

This paper takes a different empirical approach to understand the relationship between the law and firm's choices. First, by focusing on the frequency of accounting restatements it provides a measure that is more closely tied to private benefits. Second, by focusing on Nevada and the firms it attracts the study focuses only on those companies that are in game in the market for corporate law.

Nevada

Nevada market share among public corporations has increased significantly in the last decade. As Table I shows Nevada attracts 8.6% of all of out of state incorporations while according to data reported in Bebchuk and Cohen (2002) in 1999 Nevada had less than 4% of this market. While in the past Nevada attracted only a few IPOs per year and

its efforts were focused mainly on close corporations (Kahan and Kamar (2002))
currently Nevada has about 350 incorporations.

While Nevada business court is modeled after Delaware business court,⁶ its law is more protective to management than Delaware law is. As explained above Nevada provided managers and officers with stronger protection against breach of fiduciary duties claim. Nevada released managers from liability before Delaware did, and its protection is broader than the protection that section 102(b)(7) of Delaware law provides. Moreover, in 2001 Nevada changed its law to be the default law, to provide protection to officers and to cover also bad faith conduct.⁷ This stands in sharp contrast to Delaware where in 2002 the Disney court ruled that conscious disregard of duties could amount to bad faith and therefore may not get the protection 102(b)(7).

Similarly, Nevada antitakeover law is also more protective to managers. Unlike Delaware Nevada adopted 5 antitakeover statutes. Moreover, when a federal court interpretation of Nevada law could have suggested that Nevada follows Delaware

⁶ “Nevada's Business Court

· Developed on the Delaware model, the Business Court in Nevada minimizes the time, cost and risks of commercial litigation by:

- Early, comprehensive case management
- Active judicial participation in settlement
- Priority for hearing settings to avoid business disruption
- Predictability of legal decisions in commercial matters”

Why Incorporate in Nevada? Nevada secretary of state available at <http://nvsos.gov/index.aspx?page=152>

⁷ See NRS 78.138(7):

7. Except as otherwise provided in [NRS 35.230](#), [90.660](#), [91.250](#), [452.200](#), [452.270](#), [668.045](#) and [694A.030](#), or unless the articles of incorporation or an amendment thereto, in each case filed on or after October 1, 2003, provide for greater individual liability, a director or officer is not individually liable to the corporation or its stockholders or creditors for any damages as a result of any act or failure to act in his capacity as a director or officer unless it is proven that:

- (a) His act or failure to act constituted a breach of his fiduciary duties as a director or officer; and
- (b) His breach of those duties involved intentional misconduct, fraud or a knowing violation of law.

antitakeover law despite these rules the Nevada legislature stepped in to correct this possible interpretation.

In particular referring to Delaware enhanced standards in *ITT v. Hilton*, the U.S. District court for the District of Nevada noted in dicta that “[t]his Court will not eliminate the principles articulated in *Unocal*, *Blasius* and *Revlon* and the common law duties of care and loyalty without any indication from the Nevada Legislature or the Nevada Supreme Court that that is the legislative intent.”⁸ Two years after *Hilton* Nevada’s legislature stepped in to replace Delaware standards with the more lenient business judgment rule for most uses of defensive tactics.⁹ The legislative history suggests that the amendment was intended to ensure that the *Hilton* case was limited to circumstances that involve interference with shareholder voting rights:¹⁰

[T]he members of the executive committee agree with the *Hilton II* Court’s emphasis on the importance of shareholder franchise. They believe the court’s action in enjoining the ITT restructuring plan was correct because the plan did infringe on the powers of the stockholders to remove directors under the circumstances. However, the Executive Committee believes the decision contained language which *could be interpreted* [emphasis added] too broadly and wish to clarify Nevada law by changing NRS 78.138. If actions taken in response to takeover threats do not involve the disenfranchisement of stockholders the directors should obtain the benefits of the BJR without first having to establish (i) that management had reasonable grounds to believe a danger existed to the corporation, and (ii) that the response to the takeover danger was reasonable.¹¹

Thus, Nevada does not compete by emulating Delaware law as was previously suggested.

Rather, Nevada offers a different package than Delaware, one that is more protective to

⁸ 978 F. Supp. 1342, 1347 (D. Nev. 1997).

⁹ NEV. REV. STAT. ANN. § 78.139 (West 2008).

¹⁰ *Hilton* dealt with the most severe case of managers’ use of defensive tactics- interference with shareholder franchise. In such a case, Delaware, as well as many other states, would apply the *Blasius* standard—which requires managers to show a compelling justification for their acts—due to the importance of shareholder voting power as a safety valve in the presence of a pill.

¹¹ See Research Division, Legislative Council Bureau, Nevada Legislature, Bill Summary of Senate Bill 61 at 12, available at <http://www.leg.state.nv.us/lcb/research/library/1999/SB061, 1999pt1.pdf> (1999).

managers, and therefore as shown below, it attracts different firms, whose insiders have stronger appetite for private benefits.

3. Data and Methodology

We gather data for restatements resulting from the misreporting of financial information via Audit Analytics, which provides firm-level information on audit-induced financial restatements (“Auditor Engagements and Earnings Restatements”) starting in 2000. We collect the bulk of our firm-level financial information from Compustat and CRSP, although we obtain data on reincorporations via the history profile on Mergent.

To run our firm-level regressions, we construct five variables related to the performance and riskiness of the firms we examine. To measure both the growth potential of the firm and as a measure of risk, we include Tobin’s Q (*tob*), measured as the ratio market value of firm assets (market value of equity plus book value of interest-bearing debt) to book value of firm assets (book value of equity plus book value of interest bearing debt). As a measure of cash flow profitability, we include earnings before interest depreciation and amortization, scaled by the market value of assets (*ebitda_op*). To control for the level of financial leverage, we use the level of interest bearing debt by the market value of assets, leverage measure divided by total assets (*lev_op*), and as measures of firm size we examine both the market value of equity (*mve*), defined as the year-end common shares outstanding times the year-end stock price, and the market value of assets (*mva*), defined as the market value of equity plus the book value of interest bearing debt. Finally, for the subset of firms in our sample for which

data are available, we also include a measure of the age of the firm (*age*), measured as the number of years the firm has been publicly listed and tracked by CRSP.

To be included in our sample, we required firms to have complete data for calculating *tob*, *ebidta_op*, *lev_op*, *mve*, and *mva* for four consecutive years. Excluding *age*, our final sample contains 38,518 firm-year observations, which implies nine years of data on an average of 4,279 firms per year. Including *age* reduces our sample to 31,841 observations (3,537 firms per year).

3. Results

Table II reports summary statistics for our control variables, sorted by whether the firm is incorporated in Nevada, Delaware, and for all states together. Nevada firms tend to be much smaller and less profitable than Delaware firms. Potential growth opportunities – as measured by the ratio of the market value to book value of assets – tend to be much larger in Nevada firms. The higher ratio in Nevada could reflect superior stock market performance, as would be interpreted, for example in Daines (2001) or Gompers, Ishii, and Metrick (2002), or it could represent unrealized potential growth opportunities typical in young and risky firms. Nevada firms are also relatively young. The median Nevada firm is has been publicly traded for seven years, compared with the median Delaware firm of eight years, and the median over our entire sample of ten years.

Table III reports the distribution of companies across 2-digit NAIC industries, sorted according to state of incorporation. Nevada-incorporated firms tend to be more concentrated in the mining, construction and the entertainment industries than other states

(including Delaware), and tend to have a lower proportion of firms in manufacturing and information technology.

Table IV contains our primary regressions comparing restatement behavior across firms. The dependent variable in the regressions is a dummy variable equal to one if a given firm restates financials in a given year, and zero otherwise. Multiple restatements within a year are treated the same as one restatement, so no weighting occurs within a year for more than one restatement. Regression standard errors are calculated at the “group” level to account for the correlation induced by using the same firms in multiple years. The regressions in Table IV contains three different types of specifications: (1) With and without *age* (since *age* reduces our sample size), (2) With and without industry and year fixed effects, and (3) using a dependent variable that includes all restatements versus “bad restatements”, defined as restatements that lower earnings rather than raise them.

The basic setup for the regression in Table IV is to include the firm-level variables, industry and year fixed effects (when applicable), and two indicator variables: *NV_dummy*, equal to one when a firm is incorporated in Nevada, and *DE_dummy*, equal to one for a Delaware incorporate firm. The primary result from Table IV is the coefficient on *NV_dummy*, which is positive, large and significant across all regressions. The estimates indicate that a Nevada-incorporated firm is approximately 30% more likely to restate its financials in a given year when we do not control for age, and roughly 40% more likely to restate when we also control for the age of the firm. This result is robust to inclusion of industry and year fixed effects.

Overall, the results suggest that controlling for firm effects, there is something remarkable about the connection between a firm's likelihood to restate accounting numbers and incorporating in Nevada. Delaware restatement patterns, on the other hand, are not statistically distinguishable from the other non-Nevada states.

As mentioned in the introduction, we are currently engaged in a deeper exploration of the "Nevada effect" First, to investigate further the question of causality, we are setting up regressions of firm fixed effect around firms that reincorporate in Nevada versus other states. We suspect that moving the state of incorporation to Nevada does not cause an increase in restatements. Rather, firms with higher agency costs that have a tendency for restatements select Nevada as a safe place to incorporate. Our firm fixed effect regressions will allow us to either confirm or reject these educated guesses.

Second, our goal is to come closer to saying something about whether Nevada incorporation is actually "bad" for the average shareholder in a Nevada-incorporated company. To do this, we will examine stock price reactions to restatement announcements as a function of state of incorporation. Other things being equal, we suspect that stock price reactions to Nevada restatements are less negative than average. In equilibrium, Nevada shareholders should expect restatements more often and stock prices should reflect this restatement discount in advance. A larger negative stock price reaction for Nevada firms would indicate that (a) investors are not properly discounting Nevada-firm prices to reflect the poor quality of disclosures, or (b) the restatements themselves are bigger negative surprises than in other states. This similar line of thinking can also guide long-term performance studies of Nevada firms relative to firms in other states.

4. Conclusion

To be completed.

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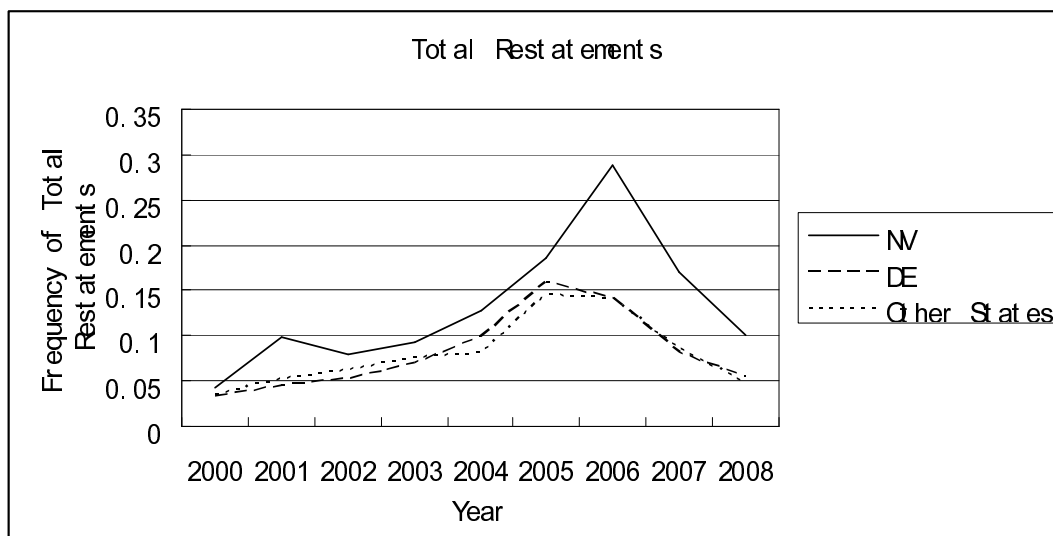
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Figure 1: Restatements of Publicly Traded Corporations as a Ratio of Total Incorporations, by State of Incorporation



Note: Frequency of total restatements is measured as the number of total restatements divided by the number of incorporations of publicly traded corporations in the states.

Table I
Summary of Out-of-State Corporations

This table presents the summary statistics of corporations in each state. Column 1 is the number of total

corporations and Column 2 is the number of out-of-state corporations, for which the most recent state of incorporation is different from the state of headquarters location. Column 3 shows the percentage of out-of-state corporations measured as the number of out-of-state corporations in each state divided by the total number of out-of-state corporations in all states.

State	Public Company Incorporations	Out-of-State Public Incorporations	Percentage of All Out- of-State Incorporations
Nevada (NV)	376	341	8.642
Delaware (DE)	3174	3160	80.081
Alaska (AK)	2	1	0.025
Alabama (AL)	1	1	0.025
Arkansas (AR)	1	0	0.000
Arizona (AZ)	12	2	0.051
California (CA)	149	21	0.532
Colorado (CO)	83	48	1.216
Connecticut (CT)	11	2	0.051
Florida (FL)	144	49	1.242
Georgia (GA)	49	6	0.152
Hawaii (HI)	2	0	0.000
Iowa (IA)	12	4	0.101
Idaho (ID)	4	2	0.051
Illinois (IL)	22	5	0.127
Indiana (IN)	32	4	0.101
Kansas (KS)	8	2	0.051
Kentucky (KY)	5	0	0.000
Louisiana (LA)	16	2	0.051
Massachusetts (MA)	80	7	0.177
Maryland (MD)	68	53	1.343
Michigan (MI)	37	1	0.025
Minnesota (MN)	127	20	0.507
Missouri (MO)	26	10	0.253
Mississippi (MS)	2	0	0.000
Montana (MT)	5	2	0.051
North Carolina (NC)	31	7	0.177
North Dakota (ND)	1	0	0.000
Nebraska (NE)	5	2	0.051
New Hampshire (NH)	1	1	0.025
New Jersey (NJ)	60	21	0.532
New Mexico (NM)	4	2	0.051
New York (NY)	134	47	1.191
Ohio (OH)	77	6	0.152
Oklahoma (OK)	18	6	0.152
Oregon (OR)	37	8	0.203
Pennsylvania (PA)	88	22	0.558
Puerto Rico (PR)	1	0	0.000
Rhode Island (RI)	5	1	0.025
South Carolina (SC)	10	1	0.025
South Dakota (SD)	3	0	0.000
Tennessee (TN)	28	5	0.127
Texas (TX)	92	7	0.177
Utah (UT)	44	24	0.608

Virginia (VA)	47	13	0.329
Vermont (VT)	1	0	0.000
Washington (WA)	61	17	0.431
Wisconsin (WI)	48	6	0.152
West Virginia (WV)	2	1	0.025
Wyoming (WY)	8	6	0.152
All States	5254	3946	100

Table II
Summary Statistics for Control Variables of Nevada, Delaware and All States

This table presents the summary of the control variables, which include Tobin's Q (tob), earnings before interest divided by total assets (ebitda_op), leverage measure divided by total assets (lev_op), market value of equity (mve), market value of assets (mva) and the age of firms (age), the difference of the fiscal year and the beginning year. This table shows the statistics for the trimmed data after dropping the observations with too many missing values. The top 1 percent and the bottom 1 percent of the data for tob, ebitda_op, mve, mva and age have been dropped and the observations with lev_op greater than 1 have been dropped. The statistics for Nevada, Delaware and all states are shown separately.

	N	Mean	SD	25 th	Median	75 th
Nevada						
tob	2586	20.107	64.441	1.289	2.760	9.329
ebitda_op	2665	-2.344	7.972	-1.217	-0.181	0.074
lev_op	2283	0.261	0.261	0.012	0.192	0.432
mve	2604	157.243	627.396	3.561	11.800	49.888
mva	2587	281.398	1166.901	7.208	18.583	79.946
age	1149	8.893	9.214	2.000	7.000	14.000
Delaware						
tob	22925	3.065	5.672	1.139	1.643	2.817
ebitda_op	24172	-0.128	0.743	-0.101	0.075	0.144
lev_op	23249	0.207	0.222	0.003	0.144	0.341
mve	23431	1357.198	3829.026	33.273	186.326	853.909
mva	22925	2115.524	5811.680	58.347	296.906	1336.576
age	21389	11.800	12.166	4.000	8.000	16.000
All States						
tob	38441	3.900	9.864	1.121	1.629	2.860
ebitda_op	40084	-0.209	1.144	-0.100	0.077	0.147
lev_op	38168	0.209	0.221	0.004	0.149	0.341
mve	39195	1174.169	3576.803	20.107	126.368	667.094
mva	38442	1801.754	5324.358	36.896	202.773	1039.819
age	37838	13.833	13.068	5.000	10.000	19.000

Table III

Industry Distribution of Nevada, Delaware and All States

This table presents industry distribution for Nevada, Delaware and all states, using 2-digit naics codes.

Industry Description	Two-Digit Naics Code	Industry Distribution		
		NV	DE	All States
Agriculture, Forestry, Fishing and Hunting	11	0.143%	0.336%	0.324%
Mining, Quarrying, and Oil and Gas Extraction	21	10.679	4.793	5.082
Construction	23	2.643	1.281	1.237
Manufacturing	31	2.821	3.543	4.130
Manufacturing	32	13.179	16.447	14.713
Manufacturing	33	21.643	27.821	28.531
Wholesale Trade	42	2.036	3.330	3.597
Retail Trade	44	2.214	2.606	3.045
Retail Trade	45	0.893	2.191	2.018
Transportation and Warehousing	48	4.250	2.432	2.379
Transportation and Warehousing	49	0.143	0.380	0.285
Information	51	13.429	15.281	14.046
Real Estate and Rental and Leasing	53	2.179	2.219	3.007
Professional, Scientific, and Technical Services	54	6.786	6.671	6.300
Administrative and Support and Waste Management and Remediation Services	56	4.321	2.792	3.083
Educational Services	61	0.214	0.502	0.476
Health Care and Social Assistance	62	2.393	2.507	2.265
Arts, Entertainment, and Recreation	71	2.643	0.807	0.914
Accommodation and Food Services	72	3.321	2.234	2.379
Other Services (except Public Administration)	81	0.179	0.289	0.457
NAICS 99 - Unclassified Establishments	99	3.893	1.538	1.732

Table IV
Regression of Total Restatements and Bad Restatements

This table presents estimates of the marginal effect of state dummies on restatements using a probit specification in panel data. Basic

control variables include earnings before interest divided by total assets (ebitda_op), leverage measure divided by total assets (lev_op), market value of assets (mva), Tobin's Q (tob) and the age of firms (age). Regression (1) shows estimates of the marginal effect of state dummy on total restatements with basic control variables. Regression (2) excludes age. In regression (3), industry fixed effect and year fixed effect are added. Regression (4) also includes industry and year fixed effect but excludes age. Regression (5), (6), (7) and (8) are similar to the first 4 regressions but the dependent variable becomes bad restatements.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Total Res. with Age (Basic Controls)	Total Res. w/o Age (Basic Controls)	Total Res. with Age (Industry/ Year Dummies)	Total Res. w/o Age (Industry/ Year Dummies)	Bad Res. with Age (Basic Controls)	Bad Res. w/o Age (Basic Controls)	Bad Res. with Age (Industry/ Year Dummies)	Bad Res. w/o Age (Industry/ Year Dummies)
NV_dummy	0.40531*** (0.06148)	0.32061*** (0.04201)	0.37266*** (0.06329)	0.29656*** (0.04328)	0.38085*** (0.06178)	0.32040*** (0.04248)	0.35484*** (0.06340)	0.29866*** (0.04362)
DE_dummy	0.03299 (0.02671)	0.02233 (0.02379)	0.02239 (0.02755)	0.01137 (0.02453)	0.03207 (0.02704)	0.01996 (0.02420)	0.02374 (0.02777)	0.00931 (0.02487)
ebitda_op	-0.00745 (0.00503)	-0.00003 (0.00039)	-0.01027* (0.00612)	-0.00013 (0.00042)	-0.00811 (0.00494)	-0.00028 (0.00045)	-0.01042* (0.00573)	-0.00043 (0.00048)
lev_op	-0.00111 (0.00265)	-0.00043 (0.00059)	-0.00049 (0.00305)	-0.00068 (0.00069)	-0.00114 (0.00268)	-0.00003 (0.00053)	-0.00068 (0.00295)	-0.00021 (0.00067)
mva	-7.78e-07 (5.63e-07)	-7.41e-07 (5.05e-07)	-7.23e-07 (6.00e-07)	-1.01e-06* (5.31e-07)	-1.12e-06* (6.48e-07)	-1.14e-06** (5.73e-07)	-1.11e-06 (6.82e-07)	-1.41e-06** (6.00e-07)
tob	-0.00018 (0.00036)	-0.00002 (0.00003)	-0.00040 (0.00066)	-0.00002 (0.00003)	-0.00016 (0.00032)	-0.000181 (0.0001195)	-0.00030 (0.00055)	-0.00019 (0.00012)
age	-0.00141 (0.00091)		-0.00242** (0.00097)		-0.00173* (0.00093)		-0.00243** (0.00099)	
_cons	-1.50929*** (0.02846)	-1.49146*** (0.02066)	-1.93993*** (0.27969)	-2.06097*** (0.25563)	-1.56153*** (0.02899)	-1.54838*** (0.02126)	-1.93251*** (0.27538)	-2.04839*** (0.25307)
N	31841	38518	31841	38518	31841	38518	31841	38518

*, ** and *** Coefficient statistically distinct from 0 at the 10%, 5% and 1% level, respectively.

Table V
Regression of Total Restatements and Bad Restatements with SOX

This table presents estimates of the marginal effect of state dummies on restatements using a probit specification in panel data. We add dummy variable sox into the regressions, which is 0 if year is 2000, 2001 or 2002, and 1 if otherwise. Interaction variables sox_NV between sox and NV_dummy and sox_DE between sox and DE_dummy are also incorporated. All regressions include industry fixed effect. Regression (1) shows estimates of the marginal effect of state dummies on total restatements with all control variables. Regression (2) excludes age. Regression (3) and (4) are similar to the first 2 regressions but the dependent variable becomes bad restatements

	(1) Total Res. with Age	(2) Total Res. w/o Age	(3) Bad Res. with Age	(4) Bad Res. w/o Age
NV_dummy	0.37246*** (0.11102)	0.31127*** (0.07674)	0.39155*** (0.11090)	0.32434*** (0.07772)
DE_dummy	-0.03944 (0.04863)	-0.02310 (0.04368)	-0.03027 (0.04926)	-0.00966 (0.04453)
sox	0.38458*** (0.04351)	0.39270*** (0.03902)	0.33993*** (0.04461)	0.36440*** (0.04016)
sox_NV	0.00063 (0.12221)	-0.01342 (0.08496)	-0.04679 (0.12381)	-0.02741 (0.08668)
sox_DE	0.08431 (0.05414)	0.04822 (0.04883)	0.07491 (0.05542)	0.02786 (0.05014)
ebitda_op	-0.00911* (0.00542)	-0.00006 (0.00040)	-0.00954* (0.00510)	-0.00034 (0.00047)
lev_op	-0.00114 (0.00332)	-0.00056 (0.00066)	-0.00120 (0.00321)	-0.00011 (0.00060)
mva	-6.42e-07 (5.85e-07)	-9.23e-07* (5.17e-07)	-1.07e-06 (6.72e-07)	-1.35e-06** (5.89e-07)
tob	-0.00026 (0.00049)	-0.00002 (0.00003)	-0.00021 (0.00038)	-0.00019 (0.00012)
age	-0.00252*** (0.00095)		-0.00256*** (0.00097)	
_cons	-2.29075*** (0.27955)	-1.94319*** (0.22295)	-2.23944*** (0.27536)	-1.99714*** (0.23045)
N	31841	38518	31841	38518