ISSN 1045-6333

DOES THE EVIDENCE FAVOR STATE COMPETITION IN CORPORATE LAW?

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Discussion Paper No. 352

02/2002

Harvard Law School
Cambridge, MA 02138

The Center for Law, Economics, and Business is supported by
a grant from the John M. Olin Foundation.

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Forthcoming, 90 California Law Review _ (2002)
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DOES THE EVIDENCE FAVOR STATE COMPETITION IN CORPORATE LAW?

Lucian Bebchuk, Alma Cohen, and Allen Ferrell***

Abstract

One of the central debates in corporate law concerns the merits of regulatory competition in this area. Supporters of state competition have long proclaimed that the empirical evidence clearly supports their view. We argue that the existing empirical evidence on which supporters of state competition have relied does not warrant this claim. The empirical evidence, we show, is in fact entirely consistent with the opposing view that state competition works poorly with respect to some corporate issues, such as takeover regulation, that substantially affect corporate managers' private interests. We also put forward a new approach to the empirical study of the subject, based on analyzing the determinants of companies' choices of state of incorporation. Evidence obtained employing this approach indicates that, contrary to the beliefs of state competition supporters, states that amass antitakeover statutes are more successful in the incorporation market. Supporters of state competition, we conclude, should revisit some strongly held positions. Our conclusions have significant policy implications for corporate governance, takeover law, and the role of federal law in the corporate area.

JEL classification: G30, G38, H70, K22.

Key words: Delaware, incorporations, corporate charters, regulatory competition, corporate governance, managers, shareholders, takeovers.

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*** Harvard Law School, Harvard Economics Department, and Harvard Law School, respectively. We are grateful to Steve Choi, James Cox, Jill Fisch, Jesse Fried, Assaf Hamdani, Bert Huang, Marcel Kahan, Jason Knott, Roberta Romano, Erich Schanz, Lynn Stout, Guhan Subramanian and workshop participants at the University of Marburg for valuable suggestions and discussions. Lucian Bebchuk and Allen Ferrell are grateful to the John M. Olin Center at Harvard Law School for its financial support.

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I. RECONSIDERING THE EVIDENCE ON STATE COMPETITION IN CORPORATE LAW

One of the most central and enduring debates in corporate law concerns the role that states play in the regulation of corporations. Simply put, what are the costs and benefits of allowing a firm, through its incorporation decision, to select which state's corporate law applies to its activities? The modern debate on the subject, which began with William Cary's attack[1] on state competition as fostering a "race to the bottom," has produced a voluminous literature.[2] The debate has had remarkable resiliency; in recent years there has been a burst of writing by legal academics weighing in on the subject.[3] Nor is interest any longer confined to U.S. academics; European policymakers now face the pressing question of how to allocate regulatory authority between the institutions of the European Union and its member national governments in the area of corporate law.[4]

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1 See William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale L.J. 663 (1974).

2 See, e.g., Ralph Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251 (1977); Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225-283 (1985); Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 1-40 (1991); Lucian Arye Bebchuk, Federalism and the Corporation, 105 Harv. L. Rev. 1435 (1992); Roberta Romano, The Genius of American Corporate Law (1993).

3 See, e.g., Marcel Kahan & Ehud Kamar, Price Discrimination in the Market for Corporate Law, 86 Cornell Law Review 1205 (2001); Leo Strine, Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law, 86 Cornell Law Review 1257 (2001); Sanjai Bhagat & Roberta Romano, Event Studies and the Law: Part II – Empirical Studies of Corporate Law, Yale ICF Working Paper No. 00-33 (2001); Stephen Choi & Andrew Guzman, Federalism and Shareholder Choice, 87 Virginia Law Review 111 (2001); Robert Daines, Does Delaware Law Improve Firm Value?, 62 Journal of Financial Economics 525 (2001); Lucian Bebchuk & Allen Ferrell, Federalism and Corporate Law: The Race to Protect Managers from Takeovers, 99 Colum. L. Rev. 1168 (1999); Lucian Bebchuk & Allen Ferrell, A New Approach to Takeover law and Regulatory Competition, 87 Virginia Law Review 111 (2001); Lucian Bebchuk & Allen Ferrell, Federal Intervention to Enhance Shareholder Choice, 87 Virginia Law Review 993 (2001); Jill Fisch, The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters, 68 University of Cincinnati Law Review 1061 (2000); Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 Colum. L. Rev. 1908 (1998).

4 Two events have recently brought these issues to the forefront; the potentially sweeping decision of the European Court of Justice in the Centros case, see Case C – 212/97, on which country's corporate law governs a firm and the recent rejection of a proposed European directive on takeover regulation.

While most commentators agree that at least some states compete for incorporations,[5] as incorporations bring various benefits to states, there has been much debate concerning the effect (for better or worse) of regulatory competition in corporate law. The dominant view is the "race to the top" school of thought. Its supporters contend that the competition among states over attracting incorporations benefits shareholders.[6] Accordingly, Delaware, the dominant state for incorporations, has "won" the race for incorporations by being the most virtuous, i.e. offering rules that maximize shareholder wealth. Indeed one prominent "race–to-the-top" theorist has referred to state competition as the "genius of American corporate law."[7]

An alternative view, to which we subscribe, holds that state competition does not work well with respect to some (but not all) important corporate law issues.[8] On this view, state competition induces states to provide rules that managers, but not necessarily shareholders, favor with respect to corporate law issues that significantly affect managers' private benefits of control, such as rules governing takeovers. It has also been suggested that state competition leads Delaware to offer a body of law that is excessively unpredictable, thus creating unnecessary litigation.[9]

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[5] For recent works indicating that competition in this market is weaker than has been generally recognized, see Marcel Kahan & Ehud Kamar, Price Discrimination in the Market for Corporate Law, 86 Cornell Law Review 1205 (2001); Lucian Bebchuk & Assaf Hamdani, Vigorous Race or Leisurely Walk: Reconsidering the Debate on State Competition in Corporate Law (working paper, 2001) (on file with authors). As long as some competitive force is at work, however weak, the question arises whether (and when) it pushes states in a beneficial or undesirable direction.

[6] For further details on this position, see Ralph Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251 (1977); Roberta Romano, The Genius of American Corporate Law (1993); Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 1-40 (1991).

[7] Roberta Romano, Genius of American Corporate Law (1993).

[8] See Lucian A. Bebchuk, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, 105 Harv. L. Rev. 1435 (1992); Lucian Bebchuk and Allen Ferrell, Federalism and Corporate Law: The Race to Protect Managers from Takeovers, 99 Colum. L. Rev. 1168 (1999); Lucian Bebchuk and Allen Ferrell, A New Approach to Takeover Law and Regulatory Competition, 87 Virg. Law Rev. 111 (2001); Oren Bar-Gill, Michal Barzuza and Lucian Bebchuk, A Model of State Competition in Corporate Law (working paper, 2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=275452; cf. William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale L.J. 663 (1974).

[9] See Marcel Kahan & Ehud Kamar, Price Discrimination in the Market for Corporate Law Cornell Law Review (2001); Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 Colum. L. Rev. 1908 (1998); cf. Jonathan R. Macey and Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 Tex. L. Rev. 469 (1987).

To shed light on this debate, researchers have undertaken a large number of empirical studies. The authors of these studies, as well as the corporate law scholars who have used the studies in their own work, have generally interpreted their findings as supporting the race-to-the-top view. Indeed, supporters of state competition have seized on these studies as strong – nay, decisive – evidence that state competition serves shareholder interests. For example, Roberta Romano has concluded that

> "[The findings of the empirical work] are *compelling* evidence that competition benefits investors." [10]

On a similar note, Frank Easterbrook and Daniel Fischel have stated:

> "Empirical studies confirm[ ] the force of competition. These findings [of the empirical literature] *fatally* undermine [the "race-to-the-bottom"] position . . ."[11]

This paper challenges this assessment of the evidence. We argue that the conclusions supporters of state competition have drawn from the empirical evidence are unjustified. In our view, interpreting the data in favor of state competition is *not* compelling but rather unwarranted. The existing evidence does *not* fatally undermine the criticisms of state competition, but rather leaves them unscathed.

Our position is supported by a new empirical approach to evaluating state competition and recent evidence generated by this method. This evidence indicates that competition rewards and encourages the amassing of antitakeover statutes by states. This new evidence calls into question the belief of supporters of state competition that state competition does not push states to adopt antitakeover statutes.

The skeptical account of state competition that we hold, and which we believe is entirely consistent with the empirical evidence, is as follows: Because managers have substantial influence over where companies are

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[10] See Roberta Romano, The Need for Competition in International Securities Regulation, Yale Law School Research Paper No. 258 (2001), at 90 (emphasis added). Professor Romano has expressed similar views in other papers. See Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 Yale. L. J. 2359 (1998) ("If a change in domicile increases firm value, it would be exceedingly difficult to maintain that charter competition is harmful to shareholders."), and Sanjai Bhagat & Roberta Romano, Event Studies and the Law: Part II – Empirical Studies of Corporate Law (working paper, 2001) ("One certainly cannot read the event study literature and conclude that firms reincorporating are reducing their shareholders' wealth, as [critics of the "race to the top" theory] contend").

[11] Frank Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 214-215 (1991) (emphasis added).

incorporated, a state wishing to maximize the number of corporations chartered in it will have to take into account the interests of managers. As a result, state competition pushes states to give significant weight to managerial interests.

Of course, catering to managerial interests is only problematic when the interests of shareholders and managers substantially diverge. Thus, on our account, state competition will likely fail with respect to issues that are "significantly redistributive" in that they involve a significant tradeoff between important managerial and shareholder interests. One area where such a divergence of interests is likely to be particularly acute is in the important area of takeover regulation. Managers interested in preserving their jobs and private benefits of control will tend to favor restrictive takeover rules, whatever the costs to shareholders.

Is the existing empirical evidence inconsistent with this skeptical account, as so many claim? Pursuing this question, Part II examines the significant body of empirical work that has sought to determine the effects of Delaware incorporation on shareholder value. This work includes a recent cross-sectional study that suggested that shareholder value is higher for Delaware companies than for non-Delaware companies, as well as reincorporation event studies that indicate that reincorporations to Delaware were accompanied by increases in stock price.

Part II closely examines the findings of both types of studies and show that, taken as a whole, they do not establish the general presence of a robust and significant association between Delaware incorporation and higher shareholder wealth. Furthermore, even assuming that a robust and significant correlation between Delaware incorporation and somewhat higher shareholder value were present, supporters of state competition have failed to distinguish satisfactorily between correlation and causation; correlation of Delaware incorporation and higher stock value does not imply causation of higher stock value by Delaware incorporation. The selection of firms that incorporate in Delaware, either initially or mid-stream, is not random.

Firms electing to incorporate in Delaware and firms not making such elections must be different in some way that accounts for their different incorporation decisions. Whatever stock price effects are correlated with Delaware incorporations might very well be due not to the direct effects of Delaware incorporation but rather to these underlying differences. Indeed, we show that there is evidence that selection effects are likely to be very much at work, and that inferences about the relative value of Delaware law cannot be reliably inferred from existing findings on correlations between Delaware incorporation and shareholder value.

Although we conclude in Part II that the existing evidence fails to demonstrate that Delaware incorporation increases shareholder value, we do

believe that it is reasonable to assume that Delaware incorporation on average benefits investors, even if in a rather small and limited way. As Part III explains, however, a marginal superiority of Delaware incorporation for shareholder value does not imply that state competition (as currently structured) benefits investors. Indeed, the presence of such a marginal superiority would be entirely consistent with our skeptical account of state competition.[12]

On our view, the incentive to cater to managerial interests, and in particular to protect managers excessively from takeovers, is present for all states that wish to attract incorporations. Consequently, all such states will be similarly pushed in an undesirable direction. In such an equilibrium, Delaware incorporation might still provide some benefits to shareholders due to Delaware's well-developed legal infrastructure and to network externalities. In such an equilibrium, however, the corporate regimes that states would adopt would nevertheless be adversely shaped by state competition.

The critical question to resolve, as Part III will emphasize, is whether the existing state competition equilibrium is superior to the set of corporate rules that would prevail in the quite different equilibrium that would obtain in the absence of the current form of state competition. This question should not be confused, as supporters of state competition seem to have done, with the question of whether Delaware is somewhat better than other states in the existing state competition equilibrium.

Part IV turns from these general considerations to consider the concrete case of state takeover regulation and what it can tell us about how state competition works in this important area. Besides its importance, state takeover regulation is an interesting case study as it presents state competition supporters with a dilemma. The dilemma lies in the fact that many supporters of state competition believe that existing state takeover law restricts corporate takeovers excessively. They have therefore been forced to reconcile this belief with their view that state competition produces desirable corporate law. To this end, they have made empirical claims that state competition has not contributed to the proliferation of antitakeover statutes but rather rewarded those states that have been comparatively moderate. Delaware, by far the most successful state in the incorporation marketplace, is usually cited as the paradigm of a state having a "moderate" takeover regime.

Part IV shows, however, that the empirical claims made by supporters of state competition fail to establish that state competition rewards

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[12] This point is formally demonstrated in a model developed in Oren Bar-Gill, Michal Barzuza and Lucian Bebchuk, A Model of State Competition in Corporate Law (working paper, 2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=275452.

moderation in the provision of antitakeover protections. First, although Delaware does not go as far as some states that have adopted extreme antitakeover statutes, it is far from clear that Delaware is relatively more moderate than most states in its antitakeover stance. Second, the studies conducted by researchers with respect to states adopting extreme antitakeover statutes (Massachusetts, Ohio, and Pennsylvania) do indicate that the adoption of these statutes have been detrimental to shareholder value, but they do not show that the incorporation marketplace has penalized these three states by reducing the number of incorporations in them. Whether these states have been in fact harmed or benefited by their adoption of extreme antitakeover protections in the incorporation marketplace is a question Part V addresses.

Part V puts forward a new, and we believe promising, approach to the empirical investigation of state competition. Researchers and corporate law scholars should seek to identify the determinants of firms' incorporation choices. While prior work has largely taken incorporation choices as given, and has sought to identify how those incorporation decisions were associated with shareholder value, the proposed approach attempts to identify the factors that determine and motivate these incorporation decisions. Furthermore, whereas prior work has largely ignored the considerable variance among states other than Delaware in their relative success in the incorporation market, we argue that this variance can be used to examine how the different legal regimes offered by states affect firms' incorporation decisions. We present some summary statistics and basic cross-state comparisons that illustrate the value of this approach. A separate study by two of us (the Domicile Decisions Study) has carried out a full empirical analysis based on this approach, which Part V will summarize and discuss.[13]

As Part V will describe, the analysis of domicile decisions reveals that the competition for incorporations does in fact reward the amassing of antitakeover protections. At one end of the spectrum, states with no antitakeover statutes, such as California, do quite poorly, retaining a relatively small fraction of the companies headquartered in them and attracting a small or even negligible number of out-of-state companies. At the other end of the spectrum, the states that are quite successful on these two dimensions are generally ones that have amassed most if not all of the

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[13] See Lucian Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=296492 (working paper, 2001).

Another contemporaneous study which applies this approach, and whose results we discuss, is Guhan Subramanian, The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the 'Race' Debate and Antitakeover Overreaching (working paper, 2001) (on file with authors).

standard antitakeover statutes. More generally, the success of a state in the market for incorporations increases with the level of antitakeover protection the state provides (controlling, of course, for company characteristics and for the characteristics of states other than their takeover laws).

Interestingly, the evidence does not show that, as supporters of state competition believe, the incorporation market penalizes states that adopt extreme antitakeover statutes, as Massachusetts, Ohio, and Pennsylvania have done. Although the adoption of these statutes were accompanied by a significant reduction in the stock value of corporations incorporated in these states, as well as being universally criticized, these statutes have not hurt these states in the incorporation market. We do no doubt that there is some level of extreme antitakeover protection that would "over-do it" and make a state adopting it less attractive for incorporators. However, in contrast to the beliefs of state competition supporters, this level has apparently not been reached by Massachusetts, Ohio, and Pennsylvania, the three states blacklisted by scholars as extreme.

The study of the determinants of domicile decisions can thus shed a more systematic light on the connection between state competition and takeover rules. Competition appears to reward, and thus encourage, the amassing of antitakeover statutes. It is therefore difficult to maintain, as many supporters of state competition have done, both that (i) state competition generally rewards the provision of rules that enhance shareholder value, and (ii) amassing antitakeover protections will restrict takeovers excessively and hurt shareholder value. At least one of these two propositions is in need of revision.

Part VI concludes that, in contrast to the long and strongly held beliefs of race-to-the-top scholars, the evidence does not favor state competition; rather it is consistent with, and in certain ways supports, the view that is skeptical of how state competition, at least as currently structured, performs with respect to certain important corporate law subjects. This conclusion has significant implications for the ongoing debates over state competition, corporate governance, and takeover law.

II. DOES DELAWARE INCORPORATION INCREASE SHAREHOLDER VALUE?

Researchers have tried to test whether Delaware law is superior by identifying how, compared with firms located in other states, incorporation in Delaware affects stock price, Tobin's Q,[14] or some other metric associated with shareholder wealth. We will examine these studies and see what they can tell us.

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[14] See Richard A. Brealey & Stewart C. Myers, Principles of Corporate Finance 775-776 (1996) (explaining Tobin's Q).

We will begin by discussing, in Part II.A, Robert Daines' influential paper measuring and comparing the Tobin's Q of Delaware and non-Delaware firms.[15] Part II.B will then look at reincorporation event studies, which measure stock price reaction to a firm's reincorporation from one state to another. In the course of discussing these studies, we will highlight some of the problems with accepting their findings at face value. With respect to some of these studies, their findings are weaker and more inconclusive than has been generally recognized. More importantly, both reincorporation event studies and Daines' Tobin's Q study suffer from a failure to establish that their findings of increased value for Delaware firms, whatever the metric being used, should be attributed to Delaware providing a superior corporate law system. It is crucial in assessing these studies to always remember that incorporation and reincorporation decisions are not random occurrences; there is thus no good basis for inferring that the measured differences in shareholder wealth are due to differences in corporate law quality as opposed to whatever influences firms' (re)incorporation decisions.

A. Tobin's Q Differences Between Delaware and Non-Delaware Corporations

1. The Correlation Findings: Questions of Robustness and Magnitude

Recognizing the limitations of reincorporation event studies, which we will discuss shortly, Robert Daines sought to test the effect of Delaware incorporation on shareholder wealth in a different way. In a recent but already influential study, he compared Delaware and non-Delaware companies in terms of Tobin's Q.[16] Tobin's Q, which is the ratio between a firm's market value and its book value, is a widely used measure of how valuable a firm's assets are. Daines found that, looking at the aggregate data from 1981-1996, Delaware companies had a higher Tobin's Q even after controlling for a variety of factors. He inferred from this finding that Delaware law accounts for the higher Tobin's Q and, therefore, acts to increase shareholder value.

However, other studies have found that the reported correlation between Delaware incorporation and a higher Tobin's Q is not a consistent phenomenon. The Domicile Decisions Study, examining data from the end of 1999, found that there was no correlation between Delaware incorporation and higher Tobin's Q for this period.[17] Furthermore, Guhan Subramanian

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[15] See Robert Daines, Does Delaware Law Improve Firm Value?, 62 Journal of Financial Economics 525 (2001).

[16] See id.

[17] See Lucian Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=296492 (working paper 2001).

reports that his work in progress found that any correlation largely disappears after 1996.[18] Finally, another recent study, using a set of controls that includes firm-level corporate governance arrangements, found that during the 1990's Delaware incorporation was, on average, associated with a *lower* Tobin's Q.[19]

Indeed, the regressions in Daines' study itself indicate that the positive correlation, using industry-adjusted Tobin's Q, did not exist in a significant number of years throughout the period he studied.[20] There were five years during this period (1982, 1987, 1989, 1991, 1995) in which there did not exist any statistically significant correlation between Delaware incorporation and Tobin's Q. In an additional year (1996), the statistical significance of the correlation was only at the 90% level.[21]

2. The Serious Problem of Selection

Consider a period in which Delaware incorporation is correlated with a higher Tobin's Q. Does this imply that Delaware incorporation caused a higher Tobin's Q? There is the fundamental question of whether the relationship between Delaware incorporation and a high Tobin's Q (or a positive abnormal price reaction in the case of reincorporation event studies) is one of causation or mere correlation. Does Delaware law cause Delaware firms to have a high Tobin's Q or do companies choosing to incorporate in Delaware tend to have a higher Tobin's Q?

If incorporation and reincorporation decisions were random, and if we could therefore safely assume that Delaware and non-Delaware firms are identical other than their state of incorporation, then differences in Tobin's Q would arguably be attributable to Delaware's superior corporate law regime. But if incorporation and reincorporation decisions are not random, and if firms that incorporate in Delaware are thus systematically different from firms that choose not to, then the differences in Tobin's Q could just as well

[18] See Guhan Subramanian, The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the 'Race' Debate and Antitakeover Overreaching, footnote 70 (November 2001 draft) (on file with authors).
[19] See Paul A. Gompers, Joy L. Ishii and Andrew Metrick, NBER Working Paper No. 8449 (August 2001). Specifically, they find that Delaware incorporation tended to be positive correlated at the beginning of the studied period and negative toward the end, with an average coefficient that was negative and significant.
[20] See Robert Daines, Does Delaware Improve Firm Value, 62 J. of Fin. Econ. 525, 535 Tbl. 3 (annual estimates).
[21] The same basic picture emerges if one uses Tobin's Q unadjusted by industry. There were four years in which there did not exist any statistically significant correlation between Delaware incorporation and (an unadjusted) Tobin's Q and one additional year in which the statistical significance of the correlation was only at the 90% level. Id. at Tbl. 3.

result from those systematic differences. Below we discuss why there is every reason to believe that the selection of firms incorporated in Delaware is anything but random.

a. Selection Follows from Daines' own Interpretation

If Daines' interpretation of his findings is correct, it necessarily follows that Delaware and non-Delaware firms differ in some systematic way besides their state of incorporation. Otherwise, why didn't all companies move to Delaware? Consider a period in which a move to Delaware could produce a 5% increase in value for companies incorporated in other states.[22] Why did some firms choose to leave so much money on the table, money they could easily have collected by simply incorporating in Delaware? There must have been something different about these firms, something significant enough to cause them to forego an easy increase in firm value. Perhaps the difference was in managerial quality, or agency costs, or firm strategy. Whatever it was, this difference must have been significant enough to cause non-reincorporating firms to forgo an easy and significant increase in firm value. It follows that there must have been some substantial, and unaccounted for, differences between Delaware and non-Delaware firms. Once such differences are admitted, however, there is a real possibility that they, rather than the purported benefits of Delaware incorporation, account for whatever differences in value exist, at any point in time, between Delaware and non-Delaware companies.

It is true that Daines' study makes a considerable effort to control for all the parameters that he could control for, such as the type of business a firm engaged in and firm size. But notwithstanding Daines' impressive effort to control for as many parameters as possible, it nonetheless remains true that if in a group of seemingly identical firms, some firms incorporate in Delaware and some do not, there *must* be some omitted variables that produce this differential behavior. This is all the more true if it is supposed that one choice produces a substantial increase in firm value and the other does not.

The presence of such variables is clearly suggested by the results of the Domicile Decisions Study. Using the Compustat database that Daines also used, this study sought to identify which characteristics make companies more or less likely to incorporate in Delaware. It found, for example, that larger and newer companies are more likely to incorporate in Delaware. For our purposes, however, the crucial point is that the study's regressions,

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22 This is based on the estimate provided by Daines' study for the value-added of Delaware law given the pooled sample estimates. Id. at Tbl. 3. As will be discussed, the value-added identified by the study fluctuates dramatically over time.

controlling for various company characteristics (which Daines also controlled for) including the industry in which firms operate and firm size, had an explanatory power of only 13% for the decision whether to incorporate in Delaware.[23] This clearly suggests the importance of omitted variables in explaining why some firms but not others choose Delaware incorporation.[24]

b. Selection and the Fluctuations of the "Delaware Effect"

Tellingly, even in the years in which there was a correlation, the magnitude of the correlation varied dramatically from year to year. For instance, Daines' regressions indicate that (controlling, of course, for other characteristics) Delaware companies had a Tobin's Q in 1986 that was 12% higher (at the 99% confidence level) than that of non-Delaware companies. In the subsequent year, 1987, however, the increase in Tobin's Q associated with Delaware incorporation was only 5%, which was statistically insignificant from zero. To take another example, in 1991 the increase in Tobin's Q associated with Delaware incorporation was 4%, also, not

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[23] See Lucian Ayre Bebchuk & Alma Cohen, Firms' Decisions Where to Incorporate, available at www.ssrn.com.

[24] It is worth commenting also on another interesting attempt by Daines to isolate his findings from the selection effect. He tries to do so by estimating the difference in Tobin's Q only between mature Delaware and mature non-Delaware firms on the theory that a firm's current valuation is unrelated with its valuation years ago. He also estimates the difference in Tobin's Q between Delaware and non-Delaware firms controlling for the prestige of the firm's underwriter at the time of its IPO, assuming that this prestige is correlated with the firm's quality and value. These tests still show a correlation between Delaware incorporation and a higher Tobin's Q.

But these test do not solve the selection problems for two reasons. First, the finding that otherwise identical firms, as captured also by their choice of an underwriter or maturity, make different choices on whether to incorporate in Delaware still raises the same type of questions. Once again, why the difference in incorporation choices if the firms really are identical, unless one believes that incorporation choices are random? And why are underwriters with similar prestige sometimes associated with Delaware incorporation and sometimes with non-Delaware incorporation, which are value-reducing?

Second, these tests cannot in any event address selection effects that occur after incorporation. We know that some type of selection among firms must be occurring because of the non-random nature of reincorporation decisions. Controlling for decisions made at the time of incorporation does not control for the type of decisions that have been made since that time, whether this is a decision to reincorporate or a decision not to reincorporate. Firms' current state of incorporation, the firms whose Tobin's Qs are being measured, will reflect these post-incorporation decisions.

statistically significant from zero, while in 1992, that figure suddenly increased to 12% (at the 99% confidence level).[25]

These huge fluctuations from year to year are deeply puzzling if one takes the view that differences in value between Delaware and non-Delaware companies are the result of the benefits of Delaware law. In order for Daines' attribution of the differences in Tobin's Q to the superiority of Delaware's corporate law regime to be plausible, there must have been groundbreaking legal changes in Delaware corporate law that occurred during these years that can account for these fluctuations. It is hard to imagine what these would be. Whatever the benefits of Delaware's legal regime and thus of Delaware incorporation, they must be more stable than that.

These fluctuations are much easier to explain with a selection story. Under this story, Delaware companies are significantly different in some underlying features – they are of a different "type" – than non-Delaware firms. And it is not unusual in the stock market for the relative pricing of firms of different types to fluctuate considerably from year to year.

c. The Magnitude of the "Delaware Effect"

There is an additional reason, aside from the fluctuations, to suspect that something else is affecting firm value besides differences in the quality of state corporate regimes. As just discussed, Daines' findings indicate that the increase in firm value correlated with Delaware incorporation is very large in some years. Indeed, the increase in value associated with Delaware incorporation exceeded 10% in five out of the eleven years in which such correlation was found to exist at the 95% confidence level.[26]

Although we strongly believe that corporate law does matter, it is hard to believe that the legal regimes of states within the U.S. differ to an extent that can produce such huge differences in share value. To be sure, Delaware incorporation might produce such an increase in value (and even more) when compared with, say, incorporation in Russia. Even the greatest fans of Delaware law, however, would not envision it producing such huge increases in value when compared with incorporation in other states. As will be stressed in Part III, the corporate regimes of states share fundamental similarities. On the other hand, such differences in Tobin's Q are consistent with a selection story. The firms that tend to incorporate in Delaware might be ones with a substantially higher firm value.

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[25] Id. at Tbl. 3.

[26] Robert Daines, Does Delaware Improve Firm Value, 62 J. of Fin. Econ. 525, 535 Tbl. 3.

d. Understanding Selection

There are various explanations that could account for why firms that have the same Compustat data characteristics make different incorporation and reincorporation decisions. Consider, for example, the following scenario.[27] Law firms centered in national financial centers such as New York City might tend to prefer Delaware incorporation. And companies that use such law firms for their counsel might be persuaded or influenced to incorporate in Delaware. It is possible that these companies may be more likely to have sophisticated and ambitious managers or have some other quality that operates to increase firm value. Of course, this scenario, based on managerial heterogeneity, is only one possible explanation and others might actually capture what is really going on.

Discovering what influences companies' incorporation decisions is an area in need of empirical work. Until such studies are available and we know a great deal more about how firms make incorporation decisions, we cannot rule out any number of possibilities, such as the one just suggested. Moreover, without an explanation for how firms make their selection decisions, the attribution of differences in firm value to differences in corporate regimes will remain questionable.

B. Event Studies of Reincorporations

A number of studies have examined stock price reaction to changes in a firm's state of incorporation. The overwhelming majority of the firms examined by these studies -- as is true with reincorporating firms as a general matter -- reincorporate to Delaware.[28] The reincorporation studies are by far the most commonly cited evidence for the proposition that Delaware corporate law increases shareholder wealth. Such studies, for instance, were largely the basis for the views of Professors Easterbrook, Fischel and Romano quoted earlier.[29]

Putting aside some general issues one might raise concerning the basic methodology underlying event studies,[30] what conclusions should we draw

[27] This story is suggested in Lucian Bebchuk and Allen Ferrell, A New Approach to Takeover Law and Regulatory Competition, 87 Virginia Law Review 111, 137-138 (2001).

[28] See Sanjai Bhagat & Roberta Romano, Event Studies and the Law: Part II – Empirical Studies of Corporate Law 3 (unpublished manuscript on file with authors) (2001); Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225-283 (1985).

[29] See supra Part I.

[30] See generally, John Rumsey, Comment, The Market Model and the Event Study Method: A Synthesis of Econometric Criticisms, 5 Int'l Rev. Fin. Analysis 79 (1996).

from these reincorporation studies? Subsection one will emphasize that in answering this question one should bear in mind the flaws in some of these event studies and that the documented positive abnormal returns associated with reincorporations are, on the whole, quite modest. Subsection two will then argue that there is no firm basis for attributing these modest positive abnormal returns to the superiority of Delaware's corporate law regime.

1. The Abnormal Returns Findings: Questions of Robustness and Magnitude

There have been eight reincorporation event studies. Overall, the picture that emerges is one of modest gains accompanying reincorporation. Six of the eight studies documented positive abnormal stock returns associated with the reincorporating firms in the sample.[31] The remaining two found negative abnormal returns associated with reincorporations; one found negative returns associated with the entire sample,[32] while the other found negative returns associated with a subgroup of the reincorporating firms.[33] Pooling the results from all eight studies, the weighted average price reaction to reincorporation is +1.28%.[34] Even accepting this finding at face value, the positive abnormal return attributable to Delaware's superior corporate law regime is rather small in magnitude. Before drawing any firm conclusions, however, it is first worth taking a closer look at these event studies.

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[31] See Jianghong Wang, Performance of Reincorporating Firms, (unpublished manuscript on file with authors) (Yale School of Management 1995); Jeffrey Netter, & Annette Poulson, State Corporation Laws and Shareholders: The Recent Experience, 18 Financial Management 29-40 (1989); Michael Bradley and Cindy A. Schipani, The Relevance of the Duty of Care Standard in Corporate Governance, 75 Iowa Law Review 1-74 (1989); Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225-283 (1985); Peter Dodd and Richard Leftwich, The Market for Corporate Charters: Unhealthy Competition v.s. Federal Regulation, 53 Journal of Business 259-283 (1980); and Allen Hyman, The Delaware Controversy—The Legal Debate, 4 Journal of Corporate Law 368-398 (1979).

[32] Randall A. Heron and Wilbur G. Lewellen, An Empirical Analysis of the Reincorporation Decision, 33 Journal of Financial and Quantitative Analysis 549-568 (1998).

[33] Pamela Peterson, Reincorporation Motives and Shareholder Wealth, 23 Financial Review 151 (1988).

[34] Returns are weighted by their sample size. In taking pooled average price reactions, we follow John C. Coates, Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence, 79 Texas Law Review 271, 283 (2000) and Michael C. Jensen & Richard S. Ruback, The Market for Corporate Control: The Scientific Evidence, J. Fin. Econ. 5, 12-13 (1983).

The two earliest reincorporation event studies used problematic methodologies that led subsequent work to view their results as unreliable.[35] Following these two initial studies, six subsequent studies used more standard and reliable methodologies. These six studies, summarized in the table below, present a rather mixed picture.[36] Roberta Romano's study, the earliest and most influential of the six, found a positive abnormal return of

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[35] In the first study, See Allen Hyman, The Delaware Controversy—The Legal Debate, 4 Journal of Corporate Law 368 (1979), Allen Hyman did find positive abnormal returns for reincorporating firms for four of the five trading days prior to the public announcement of reincorporation. But this does not tell us whether there were positive abnormal returns associated with the reincorporation announcement itself, the relevant date. Whether statistically abnormal returns for the sample occurred over a period spanning both the five days before and after the announcement day itself is unreported. On a similar note, the study does not tell us whether there was positive abnormal returns associated with the period spanning one day immediately before and after the announcement date, a commonly used time-frame for reincorporation studies. These concerns are heightened by the fact that abnormal returns were determined by reference to the performance of the Standard and Poor index, a highly unorthodox, and unreliable, methodology.

The second reincorporation event study, by Peter Dodd and Richard Leftwich, examined a sample of 140 publicly traded companies that reincorporated between 1927 and 1977. See Peter Dodd and Richard Leftwich, The Market for Corporate Charters: Unhealthy Competition v.s. Federal Regulation, 53 Journal of Business 259 (1980). The study did find statistically significant positive abnormal returns, but it used an interval of *two years* before the reincorporation date. Such an extended study period sheds little light on the effect of reincorporation. It is generally true that using an interval of a few days or weeks around an event, rather than just the day of the event itself, can still do a good job of capturing the effects of the event. However, this is not true for a two-year interval. See, e.g., Warner, Measuring Long-Horizon Security Price Performance, 43 J. Fin. Econ. 301, 301 & 337 (1997) (finding that tests of multi-year abnormal returns around firm-specific events are "severely mis-specified" and concluding that "the interpretation of long-horizon tests requires extreme caution."); Brad M. Barber & John D. Lyon, Detecting Long-Run Abnormal Stock Returns: The Empirical Power and Specification of Test Statistics, 43 J. Fin. Econ. 341, 342-43 (1997) (also finding that long-run tests are mis-specified and identifying new listing bias, rebalancing bias, and skewness bias as reasons).

[36] See Randall A. Heron and Wilbur G. Lewellen, An Empirical Analysis of the Reincorporation Decision, 33 Journal of Financial and Quantitative Analysis 549-568 (1998); Jianghong Wang, Performance of Reincorporating Firms, (unpublished manuscript on file with authors) (Yale School of Management 1995); Jeffrey Netter, and Annette Paulson, State Corporation Laws and Shareholders: The Recent Experience, 18 Financial Management 29-40 (1989); Michael Bradley and Cindy A. Schipani, The Relevance of the Duty of Care Standard in Corporate Governance, 75 Iowa Law Review 1-74 (1989); Pamela Peterson, Reincorporation Motives and Shareholder Wealth, 23 Financial Review 151 (1988); Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225-283 (1985).

4.18%.[37] However, three subsequent studies found abnormal returns in the vicinity of 1%, and two such studies, including the latest event study which used the largest sample size, did not find an abnormal return that differed from zero in a statistically significant way.[38]

Authors	Abnormal Return	Sample Size
Romano (1985)	4.18%	150
Peterson (1988)	.27%	30
Bradley & Schipani (1989)	1.04%	32
Netter & Paulson (1989)	.93%	36
Wang (1995)	.97%	145
Heron & Lewellen (1998)	-.15%	294

Thus, a 1% positive abnormal return is probably as fair a measure as any *if* one were inclined to rely on these event studies as measuring the effect of reincorporation to a superior corporate law regime.[39]Accordingly, even if the positive abnormal stock price reaction is entirely due to the benefits of Delaware incorporation, these benefits appear to be rather modest.[40] For instance, the adoption of confidential voting, which is usually not considered a significant change, has a reported positive abnormal return of approximately 1%.[41]

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37 See Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225-283 (1985).

38 See Pamela Peterson, Reincorporation Motives and Shareholder Wealth, 23 Financial Review 151 (1988); Randall A. Heron and Wilbur G. Lewellen, An Empirical Analysis of the Reincorporation Decision, 33 Journal of Financial and Quantitative Analysis 549-568 (1998). The usefulness of the latter study might be limited by the fact that it is only able to generate statistically significant results based on the motivation behind the reincorporation when the shareholder meeting date, rather than the proxy mailing date, is used. See Roberta Romano, The Need for Competition in International Securities Regulation, at 113-115.

39 The pooled weighted average abnormal return of these six studies is 1.16%.

40 We do recognize, of course, that a 1% increase in firm value can still be quite meaningful in terms of the dollars at stake.

41 John C. Coates, Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence, 79 Texas Law Review 271, 284 (pointing out positive abnormal return of adopting confidential voting is .9234%).

But should one attribute the entire positive abnormal return found in these event studies to the superiority of Delaware incorporation?

2. The Serious Problem of Confounding Events

a. The Problem

If the subset of firms reincorporating at any point in time were a random selection from the universe of all corporations, it would follow that unaccounted for increases in a reincorporating firm's stock price on the date the news of reincorporation reached the market could reasonably be attributed to Delaware's superior corporate law.[42] The randomness would help ensure that firm-specific characteristics were not affecting stock price.

However, there is good reason to believe (as was also the case when considering Daines' Tobin's Q study) that reincorporation decisions are not random, but rather are associated with or produced by specific events or occurrences, a phenomenon we will refer to as "confounding events". As a result, any findings of positive abnormal returns could well be the result not of investors' anticipation of moving to a better legal regime but rather of investors' reactions to these confounding events. The need to disentangle various effects is a generic problem that arises with the use of event studies in the field of corporate law, but its importance varies from one context to another.[43] In the case of corporate reincorporations, the presence of confounding events is a real issue that must be confronted because reincorporation decisions are clearly not random. Only some firms elect to reincorporate, and they choose to do so at a particular point in time. Thus, some event, perhaps the receipt of new information concerning the corporation or a new firm strategy, must underlie the decision of the managers of a minority of companies to pursue reincorporation to a particular state at a specific point in time. Investors could very well revise their estimates of a company's value in light of such an event, if the event is observable, or in light of the inference that such an event might have occurred, if the event is not observable. Either way, reincorporations are likely to be accompanied by investors revising their estimates of the value of reincorporating companies for reasons that have nothing to do with differences in legal regimes.

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[42] See Greene, Econometric Theory (Third Ed.)

[43] For instance, an important issue in corporate finance is the effectiveness of event studies in identifying the underlying sources of the gains that occur as a result of corporate mergers. See Gregor Andrade, Mark Mitchell, and Erik Stafford, New Evidence and Perspectives on Mergers, 15 Journal of Economic Perspectives 103, 117 (2001).

Indeed, a close examination of the reincorporation event studies confirms the view that confounding events are significant and have a considerable effect on documented returns. Most of the studies indicate reasons for believing that reincorporations are the product of significant selection effects and were accompanied by certain events (which could have caused revised valuation) or were followed by certain events (and thus could have been viewed by investors as signal that such events might indeed follow).

For example, in Romano's well-known study, in the portion of the study preceding her measurement of stock price reactions to reincorporations, Romano found that "most reincorporations preceded or coincided with a series of distinct and identifiable transactions,"[44] and that "the most plausible explanation of the reincorporation phenomenon is that corporations planning to engage in specific activities consider the choice of domicile important."[45] Such findings are consistent with the view that reincorporations are not random, and that the returns accompanying reincorporations reflect investors' reactions to events that partly coincide with, and partly might be inferred from, the reincorporation decisions.

In Romano's study, of the study's sample of 150 reincorporations, 63 were associated with an active merger and acquisitions program by the firms in question.[46] The adoption of such programs is known to be associated with positive abnormal returns.[47] Below we will discuss two other types of confounding events stories that seem plausible in light of the evidence. Each one of them could well have been present in some significant fraction of reincorporations, and could explain why, even if firms do not on average benefit from moving to Delaware's legal regime, reincorporations were accompanied by increases in company value. We do not mean this list of types of confounding events to be exhaustive; others might well have taken place.

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[44] See Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 250 (1985). Professor Romano reports that 72% of reincorporations between 1960 and 1982 were associated either with a public offering of stock, mergers, or adoption of antitakeover defenses. Roberta Romano, Genius of American Corporate Law 33 (1993).

[45] Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 250, 261 (1985).

[46] Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 250, 268 (1985).

[47] See Schipper and Thompson, Evidence on the Capitalized Value of Merger Activity for Acquiring Firms, 11 Journal of Financial Economics 85 (1983).

b. Scheduling Reincorporation Votes in Relatively Good Times

Managers interested in reincorporation might well prefer bringing reincorporation proposals to a shareholder vote when things are going well for the company or at least not going poorly. Managers are more likely to receive shareholder approval for a proposal if shareholders are content with how the company is doing overall. Managers, as they have a great deal of flexibility in terms of when a reincorporation proposal will be brought before shareholders, can time, at least to a significant extent, shareholder votes to coincide with good times.

Thus, it might be that, on average, managers bring proposals to reincorporate when news about the company's performance released at that time, or news expected to be released by the time of the vote, is better than average. Indeed, to produce an average positive stock price effect, it would be enough merely that managers avoid pursuing reincorporations at times when particularly bad news about the company is revealed. In short, according to this story, reincorporations may generally be accompanied by an upward revision in investors' valuations because investors on average receive or expect to receive before too long better than average news.

The story that managers time reincorporation votes to take place when things are going better than average sits well with a pattern established by the reincorporation event studies. As Michael Bradley and Cindy Schipani explain, "[F]irms choose to reincorporate in Delaware *after* they have experienced an abnormal run-up in their stock price."[48] Consistent with this observation, the Dodd and Leftwich reincorporation event study discussed earlier found, both for the entire sample of reincorporating firms as well as firms for which they had accurate reincorporation announcement dates, that most of the abnormal returns reincorporating firms experience occurred well before the event date. The same finding was subsequently reproduced in both Romano's 1985 event study[49] and Bradley and Schipani's 1989 event study.[50] This pattern is consistent with the view that the findings reported by the reincorporation event studies lump together abnormal returns that lead to or influence the timing of the reincorporation decision, and which could well continue to be present at the time of the reincorporation announcement, with abnormal returns that should be

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[48] Michael Bradley and Cindy A. Schipani, The Relevance of the Duty of Care Standard in Corporate Governance, 75 Iowa L. Rev. 1, 67 (1989) (emphasis added).

[49] Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225-283 (1985).

[50] Michael Bradley and Cindy A. Schipani, The Relevance of the Duty of Care Standard in Corporate Governance, 75 Iowa L. Rev. 1, 67 (1989). Bradley and Schipani found that the cumulative average return between thirty and ten days before the mailing of the reincorporation proxy materials was 6.17%.

attributed to the reincorporation announcement itself, shorn of any confounding events.

Furthermore, the Heron and Lewellen reincorporation event study report that a significant number of reincorporations in the study's raw data set had substantial coincident events such as dividend increases. Whereas Heron and Lewellen excluded these reincorporations from the sample they studied, other studies did not likewise attempt to exclude companies that increased their dividends (or had other coincident events) at the same time that they announced their plan to reincorporate, which might explain why these studies found higher positive abnormal returns associated with reincorporation than the Heron and Lewellen study.

c. Increased Likelihood of Takeover

A second plausible confounding events story centers on takeover defenses. As the reincorporation events studies indicate, a significant number of reincorporations are motivated by antitakeover considerations. Reincorporating companies often candidly admit that antitakeover considerations are a motive for seeking reincorporation.[51] When investors suspect or are told that a company is moving for such reasons, they will adjust their valuations of the company not only by (i) the direct effect of the company being subject to a different state takeover regime, but also (ii) the increased probability, inferred from the managers' focus on antitakeover considerations, of the company being a target.

Factor (ii) is generally good news and thus can be expected to have a positive effect on stock prices. Thus, the presence of factor (ii), according to this story, implies that the reported positive abnormal returns documented in reincorporation event studies represent an upward biased estimate of the effect of moving companies to a different state takeover regime. Even if it were the case that factor (i) has a sufficiently large negative effect on stock prices so that all the antitakeover-motivated reincorporations are accompanied by a negative abnormal return, this negative abnormal return would still be an upward biased estimate of the lower return caused by (i) alone. And this upward bias in the documented returns for part of the reincorporation sample biases upward, of course, average results for the sample as a whole.

[51] See, e.g., Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225, 249-261 (1985); Randall A. Heron and Wilbur G. Lewellen, An Empirical Analysis of the Reincorporation Decision, 33 Journal of Financial and Quantitative Analysis 549, 553 (1998).

d. Different Reincorporation Categories

Consistent with the significance of confounding events, two recent studies found that the abnormal returns reincorporating firms experience vary depending on the announced motivation for the firm's decision to reincorporate. Heron and Lewellen found that reincorporations motivated by a desire to erect takeover defenses were accompanied by statistically significant negative abnormal returns.[52] In contrast, reincorporations motivated by a desire to limit directors' liability resulted in positive abnormal returns.[53] Peterson's reincorporation event study also documented different abnormal returns depending on what the announced motivation for reincorporation was.[54] If the motivation for the reincorporation was defensive in nature, the abnormal return was -.16%, while other reincorporations experienced a positive abnormal return of .65%

The 1985 study by Romano broke down reincorporations into three groups – reincorporations that seemed motivated by mergers and acquisition programs, reincorporations that seemed motivated by antitakeover considerations, and a miscellaneous group consisting of all the remaining reincorporations. She found that each of the three groups had a substantially different average abnormal return but that the variance of the three associated abnormal returns was not statistically significance.[55]

In recent papers, Sanjai Bhagat and Roberta Romano argue, based on Romano's 1985 study, that confounding events do not influence the returns reported in the event studies literature.[56] Bhagat and Romano interpret the lack of statistical significance for differences between the three groups as evidence that "significant positive returns upon reincorporation are due to investors' positive assessment of the change in legal regime, and not a confounding of the impact of reincorporating firms' other future projects."[57] But this inference, which the 1985 study did not make, is unwarranted.

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[52] Randall A. Heron and Wilbur G. Lewellen, An Empirical Analysis of the Reincorporation Decision, 33 Journal of Financial and Quantitative Analysis 549-568 (1998).

[53] Id. at 550 & 557 Tbl. 5.

[54] Pamela Peterson, Reincorporation Motives and Shareholder Wealth, 23 Financial Review 151 (1988).

[55] Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 Journal of Law, Economics, and Organization 225, 272 (1985). Professor Peterson's study, which also found different abnormal returns across subgroups of reincorporating firms, did not test the statistical significance of the returns' variance.

[56] See, e.g., Sanjai Bhagat & Roberta Romano, Event Studies and the Law: Part II – Empirical Studies of Corporate Law, Yale ICF Working Paper No. 00-33. at 4 (2001).

[57] Sanjai Bhagat & Roberta Romano, Event Studies and the Law: Part II – Empirical Studies of Corporate Law (2001), at 4; see also See Roberta Romano, The Need for

To start, such an inference would overlook the different findings reached by more recent studies. Perhaps more importantly, Romano's 1985 testing was not designed to address the confounding events issue. The testing was done to examine whether reincorporations with different motivations had different effects on stock market values. Tests for confounding events should focus on all the information that was publicly known at the time of the reincorporation, and the information on which Romano's 1985 study relied differed from this category of information in two significant ways. First, Romano's analysis used for the classification information that was not publicly known at the time of the reincorporation, such as public information subsequently disclosed about acquisitions in the year following the reincorporations and the information disclosed to Romano privately in her questionnaire to firms that had reincorporated many years later. Second, Romano's analysis did not include some public information that would be relevant for studying the confounding events question, such as how the earnings and other financial disclosures of reincorporating companies that coincided with the reincorporation compared with those of non-reincorporating companies.[58]

In sum, there are good reasons, grounded in the empirical evidence, to believe that reincorporations are accompanied by confounding events that can help explain the documented positive abnormal returns. What is lacking in the literature to date is a better understanding of what is causing firms to incorporate in given times to particular jurisdictions. This is an issue we will return to in Part V.

III. DOES A MARGINAL SUPERIORITY OF DELAWARE INCORPORATION IMPLY THAT STATE COMPETITION BENEFITS INVESTORS?

Part II questioned whether the available empirical evidence demonstrates that Delaware's legal regime benefits investors more than that of other states. In this Part, we change directions and assume that incorporation in Delaware does add some value. This is a reasonable assumption: Presumably reincorporation adds some value, even if it is

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Competition in International Securities Regulation, Yale Law School Research Paper No. 258 (2001); Roberta Romano, The Genius of American Corporate Law, p.18 (1993).

[58] It also be worth noting that the breakdown of reincorporating firms into groups in Romano's study involved substantial "noise" which made it difficult to get statistically significant results. Given that the breakdown into groups involved a great deal of noise (as the study itself readily admits), the 1985 study prudentially emphasizes that this noise, "may very well be the source of the test's inability to find any significant difference among the groups." Id. at 272. The only conclusion that the 1985 study was prepared to make was that "… we cannot conclude definitely that the stock returns for the different types of reincorporations are significantly different…" Id.

difficult to measure, to the firm, otherwise shareholders would tend not to vote to reincorporate. But what are the implications of such benefits for the merits of state competition?

Many scholars, without much discussion, have assumed that the presence of benefits to shareholders from Delaware incorporation would prove that state competition benefits investors. This is not a valid inference. The relative performance of Delaware in a state competition regime and the overall performance of the state competition system are two separate issues. Findings of Delaware marginal superiority do not address the question of how well state competition is performing overall and, in particular, whether it performs better than would an alternative regime. And it is the performance of the state competition regime overall that is at the heart of the debate surrounding state competition in corporate charters.

A. The Need to Evaluate States' Collective Performance

It is worthwhile pausing to emphasize that, in many respects, the various states' corporate regimes are not all that different from each other when compared against the range of possible choices and the laws of other countries. This feature of U.S. corporate law has been well documented in William Carney's comprehensive study of state corporate law.[59] The similarity is especially noteworthy in light of the existence of fifty-one separate corporate codes and the resulting opportunity for a wide variety of approaches to many corporate law issues.[60]

Given the fundamental similarity among state corporate law regimes, assessing the collective approach that the states have adopted in most areas of corporate regulation is as important in determining the value of state competition as evaluating some of the real differences (such as in the area of takeover regulation) that do exist between states. This assessment of states' collective approach should focus on those areas where there is a substantial divergence between the interests of managers and shareholders. It is in these areas that states, including Delaware, are likely to collectively adopt a sub-optimal position.

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[59] See William J. Carney, The Production of Corporate Law, 71 S.Cal.L.Rev. 715 (1998); see also John C. Coffee, Jr., The Future as History: The Prospects for Global Convergence of Corporate Governance and Its Implications, 93 Nw. U.L. Rev. 641, 702 (1999) ("the best documented finding in the empirical literature on the U.S. corporate chartering competition is that a high degree of uniformity has emerged in American corporate laws.").

[60] For example, despite the large number of U.S. jurisdictions, none of them has offered, as the British City Code has done, a clear and categorical ban on the use of defensive tactics in the presence of a bona fide tender offer in the absence of shareholder approval. See 2 P.F.C. Begg, Corporate Acquisitions and Mergers (1998).

B. A Skeptical Account of State Competition is Consistent with Delaware Marginal Superiority

The superiority of Delaware law, as purportedly documented by the studies we reviewed in Part II of this paper, is consistent with the pro-state competition position. But, less appreciated, such a finding is equally consistent with a more skeptical theory of how state competition works and, therefore, is inconclusive in adjudicating the debate over state competition.

Indeed, a stronger statement is warranted. Any account of state competition – whether critical or supportive – that takes into account the substantial uniformity in substantive arrangements, would likely start from the premise that Delaware is marginally better. If all states have essentially the same substantive rules, it is likely the case that Delaware's unique non-substantive advantages will outweigh any of the relatively small differences that exist among state laws. Delaware is the beneficiary of network externalities and a well-developed legal infrastructure.[61]

For example, consider the following skeptical account of state competition. Just as shareholders presumably approve reincorporations when they increase firm value, a decision by managers not to reincorporate, which is not reviewable by shareholders under state law, is presumably in the interests of managers. With respect to certain corporate law subjects, there will often be a substantial divergence between the interests of managers and those of shareholders. In such circumstances, Delaware, as well as other states, will care a great deal about satisfying managers' preferences, as states will wish to prevent managers from pursuing reincorporating elsewhere.[62]

As we have argued in earlier work, corporate rules that are significantly redistributive from shareholders to managers and rules that affect the discipline of the market are likely areas where states, as a result of the competition for corporate charters, will fail to maximize shareholder wealth. The failure to maximize shareholder wealth in these areas will be true not only of Delaware, but of other states as well. As a result, it is theoretical possible for there to be a competitive equilibrium were it is true both that: (1) states adopt corporate law regimes which tend to favor managerial interests over shareholder interests where there is substantial divergence of interests; and (2) reincorporation into Delaware often provides

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[61] See generally Jill Fisch, The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters, 68 University of Cincinnati Law Review 1061 (2000).

[62] See Lucian A. Bebchuk, The Desirable Limits on State Competition, 105 Harvard Law Review 1435 (1992); Allen Ferrell & Lucian Bebchuk, Federalism and Corporate Law: The Race to Protect Managers from Takeovers, 99 Colum. L. Rev. 1168 (1999); Lucian Bebchuk & Allen Ferrell, A New Approach to Takeover Law and Regulatory Competition, 87 Virg. Law Rev. 111 (2001).

some additional value, on the margin, to shareholders if Delaware offers advantages not reflected in its substantive rules. This reasoning can be captured formally in a model where such an outcome is a competitive equilibrium.[63]

Even if it were empirically true (which we do not believe it is) that the superiority of Delaware for many shareholders lies in it having a better substantive regime, this should still be the beginning, not the end, of the analysis. It would still be the case that where states have ended up overall could still be questioned. One could, for example, imagine a takeover regime, such as the one embodied in the British City Code, far more hospitable to takeovers than that of Delaware or any other state. Or one might believe that having a regime even more protective of target management than that currently provided by any state would be preferable. A regime in which dead-hand and slow-hand poison pills were routinely used would be one such example.

IV. DOES STATE COMPETITION WORK WELL IN THE AREA OF TAKEOVER REGULATION?

Despite the substantial similarity in state corporate law regimes, there is some significant variance among states in their regulation of takeovers. Although most states have adopted some antitakeover statutes, there remain important differences between states' antitakeover stances. Supporters of states competition have sought to reconcile their position that competition works well with their view, supported in this case by the evidence, that antitakeover statutes often do not serve shareholders. To this end, they have made empirical claims that state competition does not reward, and thus does not contribute to, the adoption of antitakeover protections. As this Part shows, however, these empirical claims fail to establish that competition does not encourage the adoption of antitakeover protections.

A. The View that States Restrict Takeovers Excessively

State takeover law consists of two basic components. First, states impose rules on bidders wishing to acquire companies. These rules are

[63] See Oren Bar-Gill, Michael Barzuza, and Lucian Bebchuk, A Model of State Competition in Corporate Law (working paper, 2001), available on ssrn.com. This model does differ from the position adopted by William Cary in his Yale Law Review article in an important respect. Cary believed in a "race to the bottom" in which Delaware was offering especially poor corporate rules. In contrast, this model puts forward a race to the bottom equilibrium in which Delaware is slightly better than other states for shareholders. See William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale L.J. 663 (1974).

usually contained in antitakeover statutes. Second, takeover law includes rules governing the use of defensive tactics by managers wishing to defeat an unwanted takeover bid. In Delaware, the law on defensive tactics consists almost entirely of judge-made law. In other states, statutory law plays a more important role in the form of poison pill endorsement statutes and constituency statutes.[64]

While case law, such as Delaware's law on the use of defensive tactics, is extremely important, direct empirical evidence on the effect of takeover law on shareholder wealth has focused on antitakeover statutes, including statutes addressing the use of defensive tactics. Because these statutes are proposed and adopted on specific dates, they allow for empirical estimation of their effects. The evidence from this research consistently shows that antitakeover statutes virtually never increase firm value and, in fact, often decrease it.[65]

While a typical antitakeover statute has a negative, albeit modest, effect on shareholder value, there are three states that have gained notoriety for the extreme nature of their antitakeover statutes. Massachusetts, Ohio, and Pennsylvania have adopted antitakeover statutes that either impede or substantially reduce the attractiveness of takeovers above and beyond that normally associated with state antitakeover statutes. All three antitakeover statutes have been heavily criticized and identified in empirical studies as causing a substantial reduction in firm value.[66]

Supporters of state competition are among those who tend to believe that states often restrict takeovers excessively. For instance, Ralph Winter,

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[64] Poison pill endorsement statutes explicitly authorize the use of the "poison pill" defense against hostile takeovers, a defense that is highly effective. Constituency statutes explicitly permit target management to take into account the interests of non-shareholder groups, such as employees, as a justification in fending off hostile takeovers.

[65] See, e.g., Jonathan Karpoff & Paul Malatesta, The Wealth Effects of Second-Generation State Takeover Legislation, 25 Journal of Financial Economics 291 (1989) (forty second-generation statutes adopted in twenty-six states had, on average, a -.294 % impact on stock prices on the date the earliest know newspaper article concerning the proposed legislation appeared). For a survey of the many event studies on state antitakeover statutes, see Grant Gartman, State Antitakeover Laws (2001) (on file with authors).

[66] See Szewcyk and Tsetsekos, State Intervention in the Market for Corporate Control: The Case of Pennsylvania Senate Bill 1310, 31 Journal of Financial Economics 3 (1992) (Pennsylvania's antitakeover statute); Karpoff and Malatesta, Pennsylvania Law: State Antitakeover Laws and Stock Prices, 46 Financial Analyst Journal 8 (1990); Swartz, The 1990 Pennsylvania Antitakeover law: Should Firms Opt out of Antitakeover Legislation, 11 Journal of Accounting, Auditing, and Finance, 223 (Pennsylvania's antitakeover statute); Ryngaert and Netter (1990) (Ohio's antitakeover statute); Robert Daines, Do Staggered Boards Affect Firm Value? Massachusetts and the Market for Corporate Control, NYU Law School (2001) (Massachusetts antitakeover statute).

one of the early influential proponents of the pro-state competition position, has expressed his belief that a legal regime that facilitates takeovers increases firm value.[67] Frank Easterbrook and Daniel Fischel have famously argued that managers should be "passive" in the face of takeover and not engage in defensive tactics.[68] Another leading pro-state competition theorist, Roberta Romano, has forthrightly acknowledged the "dismal track records of most states in takeover regulation."[69]

How do supporters of state competition square this circle? The stock response has been to emphasize the fact that Delaware, the leading corporate law jurisdiction, has a less restrictive antitakeover statute than that of many other states. If the most successful state has among the mildest of antitakeover statutes, then it necessarily follows that state competition does not encourage states to impose excessive antitakeover protections. More concretely, the following four claims have been made by supporters of state competition:

(1) Delaware corporations have a higher incidence of bids and a higher acquisition rate, indicating that Delaware's takeover law is more hospitable to takeovers;
(2) Direct observation of the terms of states' antitakeover laws also reveals that Delaware's takeover regime is more hospitable;
(3) The market for incorporations has penalized those states that have enacted extreme antitakeover statutes, such as Massachusetts, Ohio, and Pennsylvania.
(4) The adoption of state antitakeover statutes is largely outside the normal parameters of state competition for incorporations.

We will question each of these four claims in turn.

B. Claims that Delaware Corporations are Acquired More Often

Robert Daines' Tobin's Q study, discussed earlier, identified Delaware's takeover regime as one of the factors accounting for a higher Tobin's Q among Delaware firms.[70] He found that Delaware firms are more likely to receive bids and are more likely to be acquired than non-Delaware

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[67] Ralph Winter, State Law, Shareholder Protection, and the Theory of the Firm, 6 J. Legal Studies at 289.

[68] Frank Easterbrook and Daniel Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 161 (1981).

[69] Roberta Romano, Competition for Corporate Charters and the Lesson of Takeover Statutes, 61 Fordham L. Rev. 843, 859 (1993).

[70] On a related note, Peter Dodd and Richard Leftwich, The Market for Corporate Charters: Unhealthy Competition v.s. Federal Regulation, 53 Journal of Business 259 (1980) attributes the high reincorporation rate to Delaware in the late 1960s to Delaware's relative permissive attitude toward mergers and tender offers. Id. at 268.

firms. Daines attributed the different bid and acquisition rate of Delaware firms to Delaware providing fewer impediments to hostile bids.

In our view, this attribution of the different bid and acquisition rates of Delaware firms to Delaware's takeover law is unwarranted for several reasons. First, although cleanly separating friendly and hostile acquisitions is tricky,[71] Daines fails to distinguish between friendly and hostile acquisitions. Because the majority of all acquisitions are friendly, the difference in acquisition incidence he reports might be due in large part to differences in the incidence of friendly acquisitions of Delaware and non-Delaware firms. Even if one were to take the view that Delaware is mildly more hospitable to hostile takeovers than other states, it would be hard to attribute a substantial difference in the incidence of friendly acquisitions to this mild difference in the treatment of hostile acquisitions.[72]

Rather than attributing the different acquisition (and bid) rate to differences in the treatment of hostile bids, the more plausible explanation for the differences between Delaware and non-Delaware firms is once again self-selection. Firms choosing to incorporate in Delaware are different in some way, and the differences between them and non-Delaware firms could be responsible for the different bid and acquisition rates. This theory is more plausible because the differences between Delaware takeover law and that of most other states are relatively minor, as we will explain in section C, and are therefore unlikely to account for the observed differences in the overall incidence of friendly and hostile acquisitions. Interestingly, in a recent empirical study, whether a target firm is a Delaware firm or not has no effect on the outcome of a hostile bid.[73] In sum, Daines' findings do not provide a firm basis for concluding that Delaware is more hospitable to takeovers than other states.

C. Claims that Delaware's Takeover Law is Relatively Moderate

It is far from clear, in fact, that Delaware offers less antitakeover protection than most other states. While it is true that some states have more antitakeover statutes or antitakeover statutes of a more extreme nature, others, such as California, have no such statutes.

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[71] See Schwert, Journal of Finance, 2000.

[72] We have learned from Guhan Subramanian that he found in his work-in-progress no differences between Delaware and non-Delaware firms in terms of the incidence of hostile bids. Thus, according to this evidence, the difference in acquisition rates is largely due to the incidence of friendly acquisitions.

[73] See Bebchuk, Coates, & Subramanian, The Antitakeover Power of Classified Boards: Theory, Evidence and Policy, (Working Paper, 2001), forthcoming in Stanford Law Review (2002).

More importantly, an assessment of Delaware's relative position cannot be based merely on a comparison of antitakeover statutes because case law plays a central role in Delaware's takeover regulation. Delaware has a well-developed body of case law making the absence of some types of antitakeover statutes practically irrelevant. Delaware's judges have played an active role in developing legal doctrines that permit the use of defensive tactics in general and the potent poison pill defense in particular. Because of the large body of Delaware judge-made law upholding the indefinite use of poison pills, there is no need for an antitakeover statute explicitly authorizing the use of poison pills, so-called poison pill endorsement statutes, or for an antitakeover constituency statute that provide managers with discretion to defend against bids.

Furthermore, Delaware's case law on the use of poison pills has rendered the absence of a control share acquisition antitakeover statute and a fair price antitakeover statute practically irrelevant; as long as a poison pill is in place, any additional antitakeover defense is superfluous since the pill completely blocks a bidder from proceeding. Were a bidder to overcome the poison pill defense by taking control of the target corporation's board in a proxy contest (and having the poison pill redeemed by the board), a control share acquisition antitakeover statute and a fair price antitakeover statute, which are usually only applicable to bids that the board does not approve of, would still be irrelevant.

In contrast, the adoption of additional antitakeover statutes might be more significant events for states with less developed case law. Poison pill endorsement statutes and constituency statutes in such states might provide managers with the confidence, notwithstanding the limited case law in the state, that indefinite use of a poison pill defense will be tolerated. Furthermore, the adoption of additional antitakeover statutes may also convey the message that the state is committed to providing substantial protection to managers against unwanted takeovers. Delaware has already set out loud and clear this message through its case law. Thus, it is far from clear that Delaware's antitakeover law is overall more moderate; any comparison between Delaware's takeover regime and those of other states must take into account the central role in takeover regulation played by Delaware's extensive case law.

Although it is difficult to directly compare Delaware's takeover regime to that of other states, much can be learned about the merits of state competition from a more systematic comparison of how other states fare in the market for incorporation when they adopt antitakeover statutes. Given that these states vary widely in their antitakeover statutes and how they fare in the incorporation market, a cross-comparison within the group of non-Delaware companies would be helpful in obtaining a better understanding

on how the incorporation market reacts to different levels of antitakeover protection. This is the approach we discuss in Part V.

D. Claims that Outlier States Have Been Penalized

Supporters of state competition often point to the extreme antitakeover statutes of Massachusetts, Ohio and Pennsylvania as examples of Delaware's virtue. Consistent with this view, scholars supporting state competition have suggested that these three states have been penalized rather than rewarded by the incorporations market as a result of their actions. Moreover, these scholars have directed some of their empirical work towards documenting the adverse effects these extreme antitakeover statutes have had on shareholders.

For instance, Robert Daines has found that Massachusetts companies have lower Tobin's Qs than those of Delaware firms.[74] In another study, Daines found that the adoption of Massachusetts' antitakeover statute was accompanied by a significant reduction in the share value of Massachusetts companies.[75] This second study is consistent with earlier studies that found strong negative stock reactions to the adoption of the antitakeover statutes of all three states. This work, however, is simply evidence that the antitakeover statutes of these states harm shareholders, a point with which we readily agree. This in no way establishes that these states have, in fact, been penalized in the market for incorporations as a result of their bad behavior (and that state competition is therefore working well).

Roberta Romano has pointed out that many Pennsylvania companies have opted out of Pennsylvania's extreme antitakeover statute.[76] She argues that this indicates that state competition has worked well. However, such an inference should not be drawn. Because the opt-out procedure under the Pennsylvania antitakeover statute was simple, the managers of Pennsylvania companies that chose to opt-out were not harmed by the passage of the statute. In contrast, those managers of companies that did not opt-out obtained substantial antitakeover protections that they would not have enjoyed otherwise. The substantial incidence of opting out thus does not imply that the passage of the Pennsylvania antitakeover statute did not serve managers of a substantial fraction of Pennsylvania companies at shareholder expense. More to the point, it does not imply that passage of the statute harmed Pennsylvania in the market for corporate charters.

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74 Robert Daines, Does Delaware Law Improve Firm Value, 62 J. of Fin. Econ. 525, 546 (2001).

75 See Robert Daines, Do Staggered Boards Affect Firm Value? Massachusetts and the Market for Corporate Control, NYU Law School (2001) (Massachusetts antitakeover statute).

76 See Roberta Romano, The Genius of American Corporate Law 68-70 (1993).

The evidence put forward by the supporters of state competition therefore fails to demonstrate that the outlier states have actually been hurt by the incorporations market, as they should have been if this market were to penalize the adoption of shareholder value-reducing corporate rules. Surprisingly, supporters of state competition have made no effort to test directly their prediction that the actions of the outlier states would actually hurt them in the incorporation market. As we shall discuss in Part V, this predicted effect does not in fact exist.

E. Claims that Antitakeover Statutes are Aimed at Attracting Incorporations

In an effort to reconcile their views on state competition and the evidence on antitakeover statutes, state competition proponents have also argued that many antitakeover statutes were passed to prevent particular, politically influential, local companies from being acquired. Therefore, proponents argue, these statutes represent an aberration outside of the normal parameters of state competition. On this view, even though the adoption of such statutes does not serve and indeed hurts the goal of attracting incorporations, states have adopted them because of the political power of some corporate targets.[77]

As Ralph Winter puts it: "The problem is not that states compete for charters but that too often they do not."[78] Accordingly, the desire to increase the number of incorporations does not encourage states to adopt antitakeover statutes but rather, to the contrary, moderates their tendency, due to lobbying by firms, to do so. This argument predicts that states that adopt antitakeover statutes to protect particular companies, disregarding the incorporations marketplace, will attract less incorporations as a result.

Supporters of state competition, however, have made no attempt to test this prediction and to examine how the adoption of antitakeover statutes actually affected states' success in the incorporations marketplace. As we shall discuss in Part V, the evidence does not confirm this prediction but rather indicates that adopting antitakeover statutes makes states more, not less, successful in the incorporations marketplace.

V. NEW EVIDENCE ON THE DETERMINANTS OF INCORPORATION DECISIONS

A. A New Approach

A natural way of getting a handle on how state competition actually works, and whether it benefits shareholders' interests, is to focus directly on

[77] See Romano, The Political Economy of Takeover Statutes, 73 Virginia L.Rev. 111 (1987).

[78] Ralph Winter, Foreword, in Romano, The Genius of American Corporate Law (1993).

how the choices states make with regard to corporate legal regimes affect their competitive position in the market for corporate charters. According to the "race to the top" position, states that adopt legal regimes destructive of shareholder wealth should suffer by attracting fewer incorporations. Conversely, states that adopt legal regimes that enhance shareholder wealth should be rewarded with increased numbers of incorporations. These are testable propositions.

Unfortunately, prior empirical work has not pursued this approach. Rather, the question it has asked is: Given incorporation decisions, does Delaware incorporation increase firm value? As Part II emphasized, this is often equivalent to assuming that incorporation decisions are random events, allowing researchers to treat the incorporation decision as a given. But the fundamental premise of the state competition debate, whichever side one takes, is that incorporation decisions are not random but deliberate.

Another shortcoming with most existing empirical work is that it typically begins its analysis by dividing the incorporation market between Delaware and non-Delaware firms. It then investigates whether incorporating in (or reincorporating to) Delaware benefits investors. This approach effectively lumps together all the non-Delaware states into one undifferentiated mass, and thus overlooks important variations that exist among the non-Delaware states.

The variations among the non-Delaware states are in fact significant in certain aspects. In particular, states vary widely in how successful they are in retaining companies already headquartered in them (in-state corporations) and in attracting corporations headquartered elsewhere (out-of-state corporations). Furthermore, although states are overall rather similar in their corporate laws, there is still significant variance among states in some areas of corporate law, such as takeover law. Thus, the variation among states both in terms of their laws and in terms of their success in the incorporation market provides a natural laboratory for examining which corporate rules make states more or less attractive.

There is yet another advantage of our approach that is worth highlighting. Delaware is a special case because of the important institutional advantages it offers shareholders. Thus, in comparisons between Delaware and non-Delaware corporations it is difficult to disentangle the effects of these institutional advantages from the effects of having different substantive corporate rules. By focusing on the large set of non-Delaware states, it is possible to make comparisons among states none of which has the special "Delaware" advantages. Removing this variable makes it easier to identify the effects that variations in legal rules have on the distribution of incorporations.

Below we illustrate the value of this approach by presenting some summary statistics and simple cross-state comparisons. A separate study by

two of us (the Domicile Decisions Study) has carried out a full empirical study of the determinants of domicile decisions.[79] We will focus on findings concerning how takeover rules affect both the ability of a state to retain in-state companies and their ability to attract out-of-state companies.[80]

The approach that we put forward can be applied to identify how other aspects of state corporate law, besides state takeover law, affects companies' domicile decisions. For example, the Domicile Decisions Study analyzes how a state's adoption of the Revised Model Business Corporation Act affects its success.[81] We focus here on takeover rules, however, because of the importance of these rules in the debate over the merits of state competition. We start by describing the basic landscape of state competition and state takeover regulation – the patterns of incorporations and the universe of state antitakeover protections.

B. The Pattern of Incorporations

How does each state fare both in terms of its in-state companies and attracting out-of-state firms? Surprisingly, the large amount of empirical work on state competition has not documented these basic patterns of incorporation. Indeed, it has not even documented how the 50% of total incorporations not captured by Delaware are currently distributed among different states.

The patterns we describe account for all the publicly traded companies for which there was data in the Compustat database at the end of 1999 and which have both their headquarters and their incorporation in the United States. There are 8,556 such companies. Table 1 displays how companies' headquarters are distributed among states – for all publicly traded companies, for all Fortune 500 companies, and for all companies that went public in the five-year period between 1996 and 2000. By "states" we mean throughout the fifty-one jurisdictions consisting of the fifty states and the District of Columbia.

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[79] See Lucian Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate (working paper, 2001), available on www.ssrn.com.

[80] Subramanian also studies empirically the effects of antitakeover statutes on the ability of states to retain their in-state companies. See Guhan Subramanian, The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the 'Race' Debate and Antitakeover Overreaching, footnote 70 (November 2001 draft) (on file with authors). As will be discussed below, his conclusions are consistent with those of the Domicile Decisions Study with respect to standard antitakeover statutes but not with respect to extreme statutes. He does not study the effect of states' antitakeover statutes on their success in attracting out-of-state incorporations.

[81] Adopting the RMBCA is found not to help states retain their in-state companies and to make states less attractive for out-of-state companies. See Lucian Bebchuk and Alma Cohen, Firms' Decisions Where to Incorporate (working paper, 2001).

Not surprisingly, states that have large populations and big economies have more companies headquartered in them. California, with the largest population and economy, is home to 17% of all companies. Its share is especially large, at 25%, among companies that went public in 1996-2000, presumably reflecting the concentration of high-tech companies in California. New York comes in second, with 11% of all companies, followed by Texas with 8%.

Table 2 displays the distribution of incorporations among states – for all publicly traded companies, for all Fortune 500 companies, and for all companies that went public in the 1996-2000 year period. A comparison of Tables 1 and 2 reveals the considerable differences between the distributions of headquarters and incorporations. As is well known, Delaware has by far the largest stock of incorporations (51% of all companies), and even a higher percentage of Fortune 500 companies, at 58%, and even larger still for companies going public in 1996-2000, at 62.55%.

Tables 3 and 4 display how each state fares in the market for incorporations with respect to all companies generally and with respect to all companies that went public in 1996-2000. The Tables display the following for each state: (i) how many of its in-state companies it retains, both in absolute numbers and as a percentage of all in-state companies; (ii) how many out-of-state companies it attracts, again in absolute numbers and as a percentage of all out-of-state incorporations, and (iii) its net flow of companies, once again both in absolute numbers and as a percentage of the number of in-state companies.

The Tables indicate that, both with respect to all companies and to all new (1996-2000) companies, the large majority of states are net "exporters" of companies. Other than Delaware, which is a huge "importer" with a positive inflow, there are only two other states that have a significant positive inflow of incorporations, Maryland and Nevada, with net inflows of 275 companies and 175 companies respectively.

The Tables also indicate that there is a great deal of variance among non-Delaware states in terms of how they fare, both in retaining in-state companies and in attracting out-of-state companies. For example, whereas California retains only 23% of its in-state companies, Ohio and Washington retain more than 50%, and Minnesota, and Indiana retain more than 70%. As for out-of-state incorporations, while 32 states attract less than 10 out-of-state incorporations each, there are six states with more than 50 each. The question on which we shall focus next is the extent to which this relative performance depends on the antitakeover statutes adopted by the various states.

C. The Landscape of State Antitakeover Statutes

Table 6, which is taken from Grant Gartman's comprehensive survey of state antitakeover statutes,[82] indicates that for each state which antitakeover statutes it has. The vast majority of these statutes were adopted in the period 1985-1991. The first six columns stand for the "standard" types of antitakeover statutes. The seventh and eighth columns stand for the extreme antitakeover statutes.

The standard antitakeover statutes are control share acquisition statutes, fair price statutes, three-year no-freezeout business combination statutes, five-year no-freezeout business combination statutes, poison pill endorsement statutes and constituency statutes. Control share acquisition statutes typically require that a would-be acquirer win approval from a majority of outstanding disinterested shares before it can acquire control. Fair price statutes attempt to ensure that an acquirer does not pay a high price for control and then buy the remaining shares at a lower price.

No-freezeout business combination statutes prohibit acquirers, under certain conditions, from merging with the acquired company for a certain number of years, typically either three or five years. Poison pill endorsement statutes explicitly authorize the use of the poison pill defense by target management. Finally, constituency statutes authorize the use of defensive tactics by target management, such as the poison pill defense, in the name of non-shareholder constituencies, such as employees.

As has been emphasized earlier, the antitakeover statutes adopted by states might have been important not only in what they actually did, but also arguably in the antitakeover message they sent. For instance, adopting the full arsenal of standard antitakeover statutes sends a clear antitakeover message to state courts and to potential and existing incorporators. Therefore, in assessing the overall level of protection against takeovers it is of interest to look at the total number of standard antitakeover statutes that a state has. In order to study cross-state differences in shareholder protection, the Domicile Decisions Study uses an antitakeover index that attaches to each state a score from 0 to 5 equal to the number of antitakeover statutes it has among the five standard types.

In addition to the standard antitakeover statutes, unusual and more restrictive statutes were adopted by three states. Pennsylvania and Ohio adopted a statute that enables the "disgorgement" or "recapture" of all the short-term profits made by a hostile bidder. Massachusetts adopted a statute that mandates a classified board structure even for companies that did not

[82] See Grant Gartman, State Takeover Laws (Investor Responsibility Research Center) (2001).

elect to have a classified board in their charter, a requirement that has a powerful antitakeover effect.[83]

D. Do Antitakeover Statutes Help States Retain In-State Corporations?

One fact that is immediately apparent from looking at the distribution of incorporations from Tables 3 and 4 is the presence of "home preference." States generally are better able to attract incorporations from companies headquartered in them than from companies headquartered elsewhere. Even states that hardly attract any out-of-state incorporations are commonly able to retain a significant fraction of their in-state companies. States do vary, however, greatly in the fraction of their in-state companies they retain.

Table 3 indicates that states without antitakeover statutes do rather poorly in terms of retaining their companies. Whereas the average fraction of in-state companies retained is 40.98%, most states with no antitakeover statutes retain a much lower fraction. For example, California retains only 23% of its in-state companies.

Conversely, Table 3 also indicates that states with all the standard antitakeover statutes generally retain a larger-than-average fraction of their in-state companies. For example, Indiana and Wisconsin, each of which offers a "royal flush" set of five standard antitakeover statutes, retain 72% and 76% respectively of its in-state companies.

Finally, observe that Pennsylvania and Ohio, which have the notorious recapture statute, retain a larger-than-average fraction of their in-state companies. Pennsylvania retains 44% of all of its in-state companies, and Ohio retains 59% of all of its in-state companies. The third "misbehaving" state, Massachusetts, retains 39% of its in-state companies, a figure just barely below the average.

Of course, these observations are just suggestive, and a more systematic testing is necessary before definite conclusions can be reached. One needs to control for other factors, besides state antitakeover statutes, that might be influencing the incorporation decisions of in-state companies. The Domicile Decisions Study accomplished this by controlling for a number of other factors that could conceivably be important, including both characteristics of the incorporating company and characteristics of the state in which the company is headquartered (other than the state's antitakeover statutes).[84]

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[83] See Lucian Bebchuk, John H. Coates & Guhan Subramanian, The Anti-takeover Power of Classified Boards: Theory, Evidence and Policy (Working paper, Harvard University Law School) (2001), forthcoming in Stanford Law Review (2002).

[84] Controlled-for characteristics of the company included the company's sales, Tobin's Q, return on assets, number of employees, and age (when the company went public). Controlled-for characteristics of the state in which the company is headquartered

This testing indicates that having a larger antitakeover index – that is, a larger number of antitakeover statutes – makes a state more likely (at 99% confidence, the highest degree of confidence conventionally used in such testing) to retain its in-state companies. Of the different antitakeover statutes, the ones most useful in attracting in-state firms are control share acquisition statutes, no-freezeout statutes with a moratorium period of more than three years, and poison pill endorsement statutes.[85]

Also consistent with the observations made above, the testing done by the Domicile Decisions Study indicates that having a recapture antitakeover statute, like Pennsylvania and Ohio, does not adversely affect a state's ability to retain its in-state companies. With regard to the classified board statute of Massachusetts, the results are mixed, depending on the type of testing done, but do not overall support the prediction that enacting such a statute would hurt an adopting state in the incorporation marketplace.[86]

E. Do Antitakeover Statutes Attract Out-of-State Corporations?

Even if antitakeover statutes help states retain in-state corporations, how do these statutes affect their competitive position in attracting out-of-state corporations? We will now turn to this second dimension of how states fare in the competition over incorporations.

Table 5 displays the distribution of out-of-state incorporations going to states other than Delaware, and it lists all the states attracting more than 6 out-of-state incorporations. Of the ten top ten states coming after Delaware

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included the state's population, number of located companies, per capita income, ideological leaning, geographic region, and whether the state has adopted the RMBCA (or its predecessor the MBCA).

[85] Guhan Subramanian also tests how the presence of standard antitakeover statutes affects states' ability to retain their headquartered companies, and his results are consistent with those obtained by the Domicile Decisions Study.

[86] In contrast to the results of the Domicile Decisions Study, Subramanian concludes that the recapture and classified boards statutes have hurt the ability of the states adopting them to retain companies. Unlike the Domicile Decision Study, he uses one dummy variable to stand for the presence of either a recapture or a classified board statute and he controls only for company characteristics but not for state characteristics other than their antitakeover statutes. Running the same regressions as Subramanian did, the Domicile Decisions Study obtained similar results to his. However, in order to allow for the possibility that the incorporations market did not treat recapture and classified boards statutes in the same way, the Domicile Decisions Study used a separate dummy variable for each of these statutes. With this specification, the recapture statute was no longer found to hurt the states adopting it even without introducing state characteristics. And once state characteristics were controlled for, the results no longer indicate a negative effect of the classified board statute.

in attracting out-of-state incorporations, nine states have either four or five antitakeover statutes.

Table 5 also indicates that the three "outlier" states, which have been blacklisted by supporters of state competition as extreme, have not been hurt in the market for out-of-state incorporations. Massachusetts holds the respectable third place (ignoring Delaware), right after Maryland and Nevada, in terms of the number of out-of-state incorporations it attracts. Pennsylvania and Ohio are among the top fifteen states in terms of the number of out-of-state incorporations they attract.

Again, definite conclusions cannot be drawn without controlling for characteristics of states and firms. The Domicile Decisions Study conducts such testing, and its conclusions confirm what is suggested by the above observations. The findings indicate that having a higher antitakeover index (i.e., more antitakeover statutes) makes a state more attractive -- again, at the high 99% confidence level -- for out-of-state incorporations. Of the different types of standard antitakeover statutes, the ones most helpful for attracting out-of-state incorporations are control share acquisition statutes and poison pill endorsement statutes.

The testing also provides clear results with respect to the two types of extreme antitakeover statutes. Neither a classified board statute nor a recapture statute have a statistically significant effect on the ability of a state to attract out-of-state incorporations. This provides further evidence against the claim that the incorporation marketplace penalizes states adopting extreme, value-reducing statutes.

F. Reconsidering Established Positions

States have been busy over the last three decades adopting antitakeover statutes. They have often gone back to the drawing board more than once, either because some earlier statutes were held unconstitutional or to take advantage of newly hatched types of antitakeover statutes. Many states have ended up with most or all the standard antitakeover statutes. However, the enthusiasm of state officials for such statutes has not been matched by shareholders. The passage of antitakeover statutes has been generally accompanied by a negative reaction or, at best, no reaction in the stock price of the companies governed by them.

With the pro-state competition position being the dominant view in corporate law scholarship, most students of corporate law have long held the following two propositions:

(1) Amassing state antitakeover statutes does not serve shareholders, and

(2) State competition rewards, and thereby induces, adopting rules that serve shareholders.

Facing a possible tension between these two propositions, supporters of state competition have sought to reconcile them by advancing an additional proposition:

(3) State competition does not reward, and indeed might discourage, the amassing of antitakeover statutes.

However, as suggested by the observations made above, and by the reported results of the Domicile Decisions Study, proposition (3) is inconsistent with the evidence. This implies that the commonly held view, which consists of holding propositions (1) and (2), can no longer be maintained. Those who have held this view should revise their position on at least one of these two propositions. Whereas the evidence discussed in this section enables rejecting (3), it does not speak directly to which revisions should be made. What is certain is that the conventional picture of state competition needs to be revisited.

Our own view is that, although some antitakeover statutes might not be harmful and even arguably beneficial at times,[87] not all are,[88] and state competition thus provides excessive incentives to restrict takeovers. If the "race to the top" story were true, it would be particularly puzzling that competition has failed to discipline the states adopting the most extreme antitakeover statutes. Although they have been the subject of strongly negative market reaction and widespread criticism by students of corporate law, these statutes have been on the books for a long time now. Still, the states having these statutes continue to fare respectably in the incorporation marketplace – both in terms of retaining in-state companies and (especially) in terms of attracting out-of-state companies.

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[87] Control share acquisitions statutes, for example, might be helpful in the absence of other arrangements in addressing pressure to tender problems. See Lucian Bebchuk, Toward Undistorted Choice and Equal Treatment in Corporate Takeovers, 95 Harvard Law Review 1695 (1985); Lucian Arye Bebchuk and Oliver Hart (2001), Takeover Bids vs. Proxy Fights in Contests for Corporate Control, NBER Working Paper No. 8633, available on http://papers.ssrn.com/sol3/papers.cfm?abstract_id=290584; Lucian Arye Bebchuk, The Case against Board Veto Power in Corporate Takeovers, forthcoming University of Chicago Law Review _ (2002).

[88] Poison pill endorsement statutes, for example, can produce excessive protection from takeovers for the large fraction of companies that have classified boards. See Lucian Bebchuk, John Coates IV, and Guhan Subramanian (2001), "The Special Antitakeover Power of Classified Boards: Theory, Evidence, and Policy," Stanford Law Review _ (2002).

Although puzzling for the conventional "race to the top" view, the adoption of antitakeover statutes and the evidence presented in this Part are not puzzling at all to those who hold to a skeptical account of state competition. On this account, state competition can be expected to produce excessive protections from takeovers. It is a natural consequence of the competitive process itself as currently structured. This process provides states with incentives to place weight on managers' interests, not solely on shareholders' interests, when selecting rules that have a major effect on managers.

VI. CONCLUSION

A recurring claim in the literature on state competition in corporate law is that the existing empirical evidence decisively supports the position of state competition's proponents. Those who are more skeptical of state competition (as currently structured), and the regulatory choices it has produced, have often been portrayed as fighting against established empirical facts. This paper has shown that this widely accepted claim is not valid.

We have shown that the body of prior evidence on which supporters of state competition rely should not be interpreted as supporting their conclusions. First, the existing evidence does not establish that Delaware incorporation produces an increase in share value. Although studies have found an association between Delaware incorporation and higher shareholder value, there are significant question with respect to the generality, robustness, and magnitude of this correlation. More importantly, correlation does not imply causation; any correlation of the sort alleged could reflect the underlying differences between firms that elect to incorporate in Delaware and those that do not.

Second, even if it were established that Delaware incorporation is marginally beneficial to investors in the existing state competition equilibrium, this does not imply that state competition benefits investors overall.

Third, we have shown that, contrary to claims made by supporters of state competition, the empirical evidence does not establish that state competition rewards moderation rather than the amassing of antitakeover statutes. In particular, the empirical claims that Delaware is more hospitable to takeovers than average, and that states hostile to takeovers are penalized by the incorporation market, do not have a solid empirical basis.

Finally, we have put forward a new approach to the empirical study of state competition, based on analyzing the determinants of companies' decisions where to incorporate. Evidence obtained using this approach indicates that, contrary to the beliefs of state competition supporters, this

competition provides strong incentives for states to offer antitakeover protections. States that amass antitakeover statutes fare better in both retaining in-state companies and attracting out-of-state incorporations. More striking still, even states with extreme antitakeover statutes, widely viewed as detrimental to shareholders, have not been penalized in the market for incorporations.

Our demonstration that the evidence does not favor state competition in corporate law (as currently structured) has important policy implications. It calls for a reconsideration of established positions on the merits of state competition and on the role of federal law in this area. It also calls for a reassessment of the body of corporate law that has been produced by state competition. In the key areas that directly affect managers' private interests, the rules that have been produced by state competition should not be regarded as presumptively value-enhancing.

Our analysis questions whether the extensive takeover protections currently afforded managers in the United States actually serve shareholders' interests. Contrary to prevailing beliefs, we have shown that state competition does not reward moderation in takeover protection. The proliferation of antitakeover statues and protections might well have been, at least partly, the product of incentives created by the incorporation market. These findings lend support to proposals for federal intervention in the takeover area, either in the form of mandatory federal takeover rules that one of us supported in earlier work,[89] or in the form of "choice-enhancing" intervention that we introduced in subsequent joint work.[90]

In sum, more attention needs to be focused on the real possibility that state competition might not work well in some important areas of corporate law. For this to happen, students of corporate law must first recognize that the empirical evidence does not at all rule out this important concern, but rather highlights its relevance. We hope that this paper will help bring about such recognition.

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[89] See Lucian Ayre Bebchuk, Federalism and the Corporation: the Desirable Limits on State Competition, 105 Harv. L. Rev. 1435 (1992).

[90] See Lucian Ayre Bebchuk & Allen Ferrell, A New Approach to Takeover law and Regulatory Competition, 87 Virg. L. Rev. 111 (2001); Lucian Ayre Bebchuk & Allen Ferrell, Federal Intervention to Enhance Shareholder Choice, 87 Virg. L. Rev. 993 (2001).

TABLE 1

THE DISTRIBUTION OF COMPANIES AMONG STATES OF HEADQUARTERS

All publicly traded Companies

State	Number of firms located in state	Percentage
CA	1437	16.80%
NY	954	11.15%
TX	693	8.10%
MA	499	5.83%
IL	426	4.98%
NJ	414	4.84%
FL	408	4.77%
PA	351	4.10%
OH	267	3.12%
MN	248	2.90%
CO	235	2.75%
GA	216	2.52%
VA	192	2.24%
CT	184	2.15%
WA	157	1.83%
MD	143	1.67%
MI	141	1.65%
NC	135	1.58%
MO	130	1.52%
AZ	105	1.23%
IN	104	1.22%
TN	100	1.17%
WI	90	1.05%
OR	81	0.95%
UT	77	0.90%
Other	769	8.99%
Total	8556	100%

Fortune 500 Companies

State	Number of firms located in state	Percentage
CA	50	10.96%
NY	50	10.96%
TX	38	8.33%
IL	35	7.68%
OH	28	6.14%
PA	26	5.70%
NJ	20	4.39%
VA	16	3.51%
MI	15	3.29%
MO	15	3.29%
GA	14	3.07%
CT	13	2.85%
MA	13	2.85%
FL	12	2.63%
MN	12	2.63%
NC	12	2.63%
WA	10	2.19%
WI	9	1.97%
AL	7	1.54%
TN	6	1.32%
DE	5	1.10%
MD	5	1.10%
AR	4	0.88%
AZ	4	0.88%
CO	4	0.88%
Other	33	7.24%
Total	456	100%

Companies going public during 1996-2000

State	Number of firms located in state	Percentage
CA	601	24.65%
NY	243	9.97%
TX	192	7.88%
MA	166	6.81%
FL	140	5.74%
NJ	90	3.69%
IL	85	3.49%
PA	74	3.04%
CO	73	2.99%
GA	69	2.83%
WA	64	2.63%
VA	61	2.50%
MN	54	2.21%
MD	47	1.93%
CT	46	1.89%
OH	40	1.64%
NC	38	1.56%
MI	32	1.31%
AZ	30	1.23%
MO	28	1.15%
TN	25	1.03%
OR	18	0.74%
UT	18	0.74%
DC	17	0.70%
LA	15	0.62%
Other	172	7.05%
Total	2438	100%

TABLE 2

THE DISTRIBUTION OF STATES OF INCORPORATION

All publicly traded Companies

State	Number of firms incorporate in state	Percentage
DE	4385	51.27%
MD	418	4.89%
CA	341	3.99%
MA	310	3.62%
NY	302	3.53%
MN	245	2.86%
NV	243	2.84%
TX	205	2.40%
FL	202	2.36%
PA	185	2.16%
OH	170	1.99%
CO	145	1.70%
NJ	145	1.70%
GA	116	1.36%
VA	101	1.18%
WA	100	1.17%
IN	87	1.02%
MI	82	0.96%
WI	73	0.85%
NC	70	0.82%
OR	64	0.75%
UT	59	0.69%
MO	56	0.65%
TN	49	0.57%
IL	42	0.49%
Other	357	4.17%
Total	8552	100%

Fortune 500 Companies

State	Number of firms incorporate in state	Percentage
DE	263	58.44%
NY	26	5.78%
OH	20	4.44%
PA	15	3.33%
NJ	13	2.89%
MD	9	2.00%
NC	9	2.00%
VA	9	2.00%
IN	8	1.78%
FL	7	1.56%
GA	7	1.56%
CA	6	1.33%
MN	6	1.33%
TX	6	1.33%
WA	6	1.33%
MA	5	1.11%
MI	5	1.11%
NV	5	1.11%
IL	4	0.89%
MO	4	0.89%
KS	3	0.67%
DC	2	0.44%
KY	2	0.44%
OR	2	0.44%
RI	2	0.44%
Other	6	1.33%
Total	450	100%

Companies going public during 1996-2000

State	Number of firms incorporate in state	Percentage
DE	1525	62.55%
CA	106	4.35%
MD	83	3.40%
NV	77	3.16%
FL	73	2.99%
MA	57	2.34%
TX	57	2.34%
CO	42	1.72%
WA	42	1.72%
MN	39	1.60%
NY	38	1.56%
GA	37	1.52%
PA	29	1.19%
OH	25	1.03%
VA	24	0.98%
NJ	19	0.78%
MI	18	0.74%
NC	16	0.66%
OR	15	0.62%
TN	13	0.53%
IN	11	0.45%
MO	11	0.45%
UT	11	0.45%
LA	9	0.37%
WI	9	0.37%
Other	52	2.13%
Total	2438	100%

TABLE 3

MIGRATION OF COMPANIES IN THE "MARKET OF CORPORATE LAW:" ALL PUBLICLY TRADED COMPANIES

State	Number of firms located in state	Percentage	Number of firms located and incorporate in state	As percentage of all firms located in this state	Number of firms located in state but incorporate in Delaware	As percentage of the number of firms located in state but incorp elsewhere	Number of firms located elswhere but incorporate in state	As percentage of all out-of state incorp	Net flow	As percentage of the number of firms located in state
AK	3	0.04%	2	66.67%	1	100.00%	2	0.02%	-1	-33.33%
AL	53	0.62%	6	11.32%	44	93.62%	2	0.02%	45	84.91%
AR	24	0.28%	5	20.83%	16	84.21%	1	0.01%	18	75.00%
AZ	105	1.23%	27	25.71%	48	61.54%	1	0.01%	77	73.33%
CA	1,437	16.80%	326	22.69%	979	88.12%	15	0.21%	1096	76.27%
CO	235	2.75%	82	34.89%	113	73.86%	63	0.76%	90	38.30%
CT	184	2.15%	25	13.59%	136	85.53%	4	0.05%	155	84.24%
DC	38	0.44%	7	18.42%	24	77.42%	2	0.02%	29	76.32%
DE	37	0.43%	35	94.59%	35	1750.00%	4,350	51.06%	-4348	-11751.35%
FL	408	4.77%	169	41.42%	180	75.31%	33	0.41%	206	50.49%
GA	216	2.52%	103	47.69%	92	81.42%	13	0.16%	100	46.30%
HI	17	0.20%	9	52.94%	5	62.50%	2	0.02%	6	35.29%
IA	41	0.48%	21	51.22%	14	70.00%	5	0.06%	15	36.59%
ID	16	0.19%	2	12.50%	10	71.43%	1	0.01%	13	81.25%
IL	426	4.98%	37	8.69%	246	63.24%	5	0.06%	384	90.14%
IN	104	1.22%	75	72.12%	22	75.86%	12	0.14%	17	16.35%
KS	47	0.55%	17	36.17%	20	66.67%	8	0.09%	22	46.81%
KY	50	0.58%	19	38.00%	27	87.10%	2	0.02%	29	58.00%
LA	54	0.63%	26	48.15%	23	82.14%	4	0.05%	24	44.44%
MA	499	5.83%	194	38.88%	254	83.28%	116	1.44%	189	37.88%
MD	143	1.67%	51	35.66%	80	86.96%	367	4.36%	-275	-192.31%
ME	16	0.19%	10	62.50%	5	83.33%	1	0.01%	5	31.25%
MI	141	1.65%	80	56.74%	48	78.69%	2	0.02%	59	41.84%
MN	248	2.90%	186	75.00%	54	87.10%	59	0.71%	3	1.21%
MO	130	1.52%	44	33.85%	71	82.56%	12	0.14%	74	56.92%
MS	21	0.25%	9	42.86%	7	58.33%	6	0.07%	6	28.57%
MT	9	0.11%	6	66.67%	2	66.67%	0	0.00%	3	33.33%
NC	135	1.58%	62	45.93%	55	75.34%	8	0.10%	65	48.15%
ND	7	0.08%	1	14.29%	4	66.67%	0	0.00%	6	85.71%
NE	26	0.30%	7	26.92%	16	84.21%	4	0.05%	15	57.69%
NH	31	0.36%	4	12.90%	25	92.59%	0	0.00%	27	87.10%
NJ	414	4.84%	113	27.29%	210	69.77%	32	0.39%	269	64.98%
NM	17	0.20%	7	41.18%	6	60.00%	3	0.04%	7	41.18%
NV	68	0.79%	48	70.59%	11	55.00%	195	2.30%	-175	-257.35%
NY	954	11.15%	211	22.12%	511	68.78%	91	1.20%	652	68.34%
OH	267	3.12%	157	58.80%	83	75.45%	13	0.16%	97	36.33%
OK	66	0.77%	26	39.39%	32	80.00%	6	0.07%	34	51.52%
OR	81	0.95%	59	72.84%	17	77.27%	5	0.06%	17	20.99%
PA	351	4.10%	155	44.16%	161	82.14%	30	0.37%	166	47.29%
PR	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
RI	30	0.35%	9	30.00%	15	71.43%	2	0.02%	19	63.33%
SC	49	0.57%	21	42.86%	26	92.86%	2	0.02%	26	53.06%
SD	10	0.12%	4	40.00%	6	100.00%	0	0.00%	6	60.00%
TN	100	1.17%	43	43.00%	42	73.68%	6	0.07%	51	51.00%
TX	693	8.10%	195	28.14%	402	80.72%	10	0.13%	488	70.42%
UT	77	0.90%	35	45.45%	30	71.43%	24	0.28%	18	23.38%
VA	192	2.24%	81	42.19%	85	76.58%	20	0.24%	91	47.40%
VT	13	0.15%	5	38.46%	7	87.50%	0	0.00%	8	61.54%
WA	157	1.83%	88	56.05%	62	89.86%	12	0.14%	57	36.31%
WI	90	1.05%	68	75.56%	17	77.27%	5	0.06%	17	18.89%
WV	15	0.18%	7	46.67%	3	37.50%	0	0.00%	8	53.33%
WY	11	0.13%	4	36.36%	3	42.86%	13	0.15%	-6	-54.55%
Total	8556		2983		4385		5569			
Average		1.92%		40.98%		107.03%		1.27%		-190.31%

TABLE 4

THE "MARKET OF CORPORATE LAW" FOR COMPANIES GOING PUBLIC DURING 1996-2000

State	Number of firms located in state	Percentage	Number of firms located and incorporate in state	As percentage of all firms located in this state	Number of firms located in state but incorporate in Delaware	As percentage of the number of firms located in state but incorp elsewhere	Number of firms located elswhere but incorporate in state	As percentage of all out-of state incorp	Net flow	As percentage of the number of firms located in state
AK	1	0.04%	0	0.00%	1	100.00%	0	0.00%	1	100.00%
AL	7	0.29%	1	14.29%	6	100.00%	0	0.00%	6	85.71%
AR	5	0.21%	1	20.00%	3	75.00%	0	0.00%	4	80.00%
AZ	30	1.23%	5	16.67%	17	68.00%	0	0.00%	25	83.33%
CA	601	24.65%	104	17.30%	456	91.75%	2	0.11%	495	82.36%
CO	73	2.99%	23	31.51%	48	96.00%	19	0.80%	31	42.47%
CT	46	1.89%	2	4.35%	41	93.18%	0	0.00%	44	95.65%
DC	17	0.70%	2	11.76%	11	73.33%	0	0.00%	15	88.24%
DE	8	0.33%	8	100.00%	8	0.00%	1,517	62.43%	-1517	-18962.50%
FL	140	5.74%	61	43.57%	61	77.22%	12	0.52%	67	47.86%
GA	69	2.83%	34	49.28%	32	91.43%	3	0.13%	32	46.38%
HI	4	0.16%	1	25.00%	1	33.33%	0	0.00%	3	75.00%
IA	7	0.29%	4	57.14%	2	66.67%	0	0.00%	3	42.86%
ID	4	0.16%	0	0.00%	4	100.00%	0	0.00%	4	100.00%
IL	85	3.49%	5	5.88%	64	80.00%	1	0.04%	79	92.94%
IN	14	0.57%	9	64.29%	3	60.00%	2	0.08%	3	21.43%
KS	12	0.49%	4	33.33%	5	62.50%	3	0.12%	5	41.67%
KY	12	0.49%	3	25.00%	5	55.56%	0	0.00%	9	75.00%
LA	15	0.62%	8	53.33%	5	71.43%	1	0.04%	6	40.00%
MA	166	6.81%	48	28.92%	112	94.92%	9	0.40%	109	65.66%
MD	47	1.93%	14	29.79%	31	93.94%	69	2.89%	-36	-76.60%
ME	7	0.29%	4	57.14%	3	100.00%	0	0.00%	3	42.86%
MI	32	1.31%	17	53.13%	13	86.67%	1	0.04%	14	43.75%
MN	54	2.21%	35	64.81%	17	89.47%	4	0.17%	15	27.78%
MO	28	1.15%	8	28.57%	16	80.00%	3	0.12%	17	60.71%
MS	4	0.16%	1	25.00%	2	66.67%	0	0.00%	3	75.00%
MT	1	0.04%	1	100.00%	0	0.00%	0	0.00%	0	0.00%
NC	38	1.56%	13	34.21%	22	88.00%	3	0.13%	22	57.89%
ND	3	0.12%	1	33.33%	1	50.00%	0	0.00%	2	66.67%
NE	5	0.21%	1	20.00%	3	75.00%	1	0.04%	3	60.00%
NH	8	0.33%	0	0.00%	8	100.00%	0	0.00%	8	100.00%
NJ	90	3.69%	17	18.89%	57	78.08%	2	0.09%	71	78.89%
NM	6	0.25%	1	16.67%	2	40.00%	0	0.00%	5	83.33%
NV	15	0.62%	11	73.33%	3	75.00%	66	2.72%	-62	-413.33%
NY	243	9.97%	33	13.58%	179	85.24%	5	0.23%	205	84.36%
OH	40	1.64%	23	57.50%	15	88.24%	2	0.08%	15	37.50%
OK	11	0.45%	4	36.36%	7	100.00%	0	0.00%	7	63.64%
OR	18	0.74%	12	66.67%	5	83.33%	3	0.12%	3	16.67%
PA	74	3.04%	24	32.43%	38	76.00%	5	0.21%	45	60.81%
RI	6	0.25%	1	16.67%	4	80.00%	0	0.00%	5	83.33%
SC	12	0.49%	3	25.00%	8	88.89%	1	0.04%	8	66.67%
SD	1	0.04%	0	0.00%	1	100.00%	0	0.00%	1	100.00%
TN	25	1.03%	11	44.00%	11	78.57%	2	0.08%	12	48.00%
TX	192	7.88%	52	27.08%	118	84.29%	5	0.22%	135	70.31%
UT	18	0.74%	5	27.78%	12	92.31%	6	0.25%	7	38.89%
VA	61	2.50%	22	36.07%	34	87.18%	2	0.08%	37	60.66%
VT	2	0.08%	0	0.00%	2	100.00%	0	0.00%	2	100.00%
WA	64	2.63%	39	60.94%	23	92.00%	3	0.13%	22	34.38%
WI	14	0.57%	8	57.14%	3	50.00%	1	0.04%	5	35.71%
WV	2	0.08%	0	0.00%	1	50.00%	0	0.00%	2	100.00%
WY	1	0.04%	0	0.00%	1	100.00%	1	0.04%	0	0.00%
Total	2438		684		1525		1754			
Average		1.96%		32.50%		77.43%		1.42%		-322.51%

TABLE 5

THE DIVISION OF THE MARKET FOR OUT-OF-STATE INCORPORATIONS

All publicly traded companies

State	Number of firms located elsewhere but incorporate in state	As percentage of all out-of-state firms
DE	4,350	78.11%
MD	367	6.59%
NV	195	3.50%
MA	116	2.08%
NY	91	1.63%
CO	63	1.13%
MN	59	1.06%
FL	33	0.59%
NJ	32	0.57%
PA	30	0.54%
UT	24	0.43%
VA	20	0.36%
CA	15	0.27%
GA	13	0.23%
OH	13	0.23%
WY	13	0.23%
IN	12	0.22%
MO	12	0.22%
WA	12	0.22%
TX	10	0.18%
KS	8	0.14%
NC	8	0.14%
MS	6	0.11%
Other	67	1.20%
Total	5,569	100%

Fortune 500

State	Number of firms located elsewhere but incorporate in state	As percentage of all out-of-state
DE	259	83.82%
NY	9	2.91%
MD	5	1.62%
NV	5	1.62%
IN	4	1.29%
NJ	4	1.29%
PA	4	1.29%
KS	3	0.97%
OH	3	0.97%
NC	2	0.65%
VA	2	0.65%
DC	1	0.32%
FL	1	0.32%
GA	1	0.32%
HI	1	0.32%
KY	1	0.32%
MA	1	0.32%
RI	1	0.32%
TN	1	0.32%
UT	1	0.32%
Total	309	100.00%

Companies going public during 1996-2000

State	Number of firms located elsewhere but incorporate in state	As percentage of all out-of-state
DE	1,517	86.49%
MD	69	3.93%
NV	66	3.76%
CO	19	1.08%
FL	12	0.68%
MA	9	0.51%
UT	6	0.34%
NY	5	0.29%
PA	5	0.29%
TX	5	0.29%
MN	4	0.23%
GA	3	0.17%
KS	3	0.17%
MO	3	0.17%
NC	3	0.17%
OR	3	0.17%
WA	3	0.17%
CA	2	0.11%
IN	2	0.11%
NJ	2	0.11%
OH	2	0.11%
TN	2	0.11%
VA	2	0.11%
Other	7	0.40%
Total	1,754	100%

TABLE 6 – STATE TAKEOVER LAWS

State	State code	Control Share	Fair Price	2- to 5- years Freeze-out	Poison Pill Endorsement	Constituency	Profit Recapture	Classified Board
Alaska	AK							
Alabama	AL							
Arkansas	AR							
Arizona	AZ	X	X	3		X		
California	CA							
Colorado	CO				X			
Connecticut	CT		X	5		X		
DC	DC							
Delaware	DE			3				
Florida	FL	X	X		X	X		
Georgia	GA		X	5	X	X		
Hawaii	HI	X			X	X		
Iowa	IA			3	X	X		
Idaho	ID	X	X	3	X	X		
Illinois	IL		X	3	X	X		
Indiana	IN	X	X	5	X	X		
Kansas	KS	X		3				
Kentucky	KY		X	5	X	X		
Louisiana	LA	X	X			X		
Massachusetts	MA	X		5	X	X		X
Maryland	MD	X	X	5	X	X		
Maine	ME					X		
Michigan	MI	X	X	5				
Minnesota	MN	X	X	4		X		
Missouri	MO	X	X	5		X		
Mississippi	MS	X	X			X		
Montana	MT							
North Carolina	NC	X	x		X			
North Dakota	ND					X		
Nebraska	NE	X		5				
New Hampshire	NH							
New Jersey	NJ		X	5	X	X		
New Mexico	NM					X		
Nevada	NV	X	X	3	X	X		
New York	NY		X	5	X	X		
Ohio	OH	X	X	3	X	X	X	
Oklahoma	OK	X		3				
Oregon	OR	X		3	X	X		
Pennsylvania	PA	X	X	5	X	X	X	
Rohde Island	RI		X	5	X	X		
South Carolina	SC	X	X	2				
South Dakota	SD	X	X	4	X	X		
Tennessee	TN	X	X	5	X	X		
Texas	TX			3				
Utah	UT	X			X			
Virginia	VA	X	X	3	X			
Vermont	VT					X		
Washington	WA		X	5	X			
Wisconsin	WI	X	X	3	X	X		
West Virginia	WV							
Wyoming	WY	X		3		X		