Journal of Banking and Finance 74 (2017) 85–101

Contents lists available at ScienceDirect

Journal of Banking and Finance

journal homepage: www.elsevier.com/locate/jbf

Do Delaware CEOs get fired?☆

Murali Jagannathan[a], A.C. Pritchard[b,*]

[a] Binghamton University, AA210, School of Management, Binghamton, NY 13902, US
[b] University of Michigan Law School, 1039 Legal Research, Ann Arbor, Michigan 48109, US

ARTICLE INFO

Article history:
Received 19 March 2015
Accepted 18 October 2016
Available online 29 October 2016

JEL Classification:
G30
G34
K22

Keywords:
Corporate governance
Charter competition
CEO turnover

ABSTRACT

Critics have charged that state competition in corporate law, which Delaware dominates, leads to a "race to the bottom" making management unaccountable. We argue that Delaware corporate law attracts firms with particular financial and governance characteristics. We find that Delaware attracts growth firms in industries with more takeover activity. Delaware firms have smaller boards, and their directors are paid more and serve on more boards. In addition, Delaware firms attract greater institutional ownership. We also provide a bottom-line test of the race-to-the-bottom hypothesis by examining forced CEO turnover. After controlling for differences in firm characteristics, we find that firms incorporated in Delaware are more likely to terminate CEOs. We also find that that termination decision is less sensitive to poor performance. Overall, we see no clear pattern supporting the "race to the bottom" hypothesis.

1. Introduction

In this paper, we examine the relation between state corporate law and corporate governance. State corporate law determines most questions of internal corporate governance, such as the role of boards of directors and the allocation of authority between directors, managers and shareholders. Companies have discretion in choosing their state of incorporation. The allocation to the states of primary authority over corporate governance, when combined with the "internal affairs" doctrine, which holds that courts must apply the law of the state of incorporation to corporate law disputes, has created a regime of "issuer choice" in state corporate law. Issuer choice allows corporations to choose their preferred state corporate law without regard to where the corporation is headquartered or principally does business.

Issuer choice implies that states can compete to attract firms by offering the most attractive corporate law regime. Delaware has clearly prevailed in the competition for corporate charters. That state draws a clear majority of the nation's largest public companies to incorporate under its corporate code, despite its relatively small population and share of the national economy. In 2014, nearly 89% of companies doing initial public offerings (IPOs) in the United States were incorporated in Delaware.[1] Subramanian (2002) suggests that the competition for corporate charters is largely bilateral: states compete with Delaware in an effort to retain corporate charters. This competition for corporate charters is not just about state pride: Winning the competition for incorporations yields tangible benefits: Charter fees made up more than a quarter of Delaware's tax revenues in 2014.[2]

Critics of issuer choice argue that Delaware competes for corporate charters by pandering to management. Delaware has won this competition, they claim, by leaving shareholders vulnerable to overreaching by corporate managers, who dominate the incorporation decision. Most famously, William Cary (1974), a former SEC chairman, charged that states were caught in a "race to the bottom," providing rules that undermine management accountability to shareholders.

To test this hypothesis, we first develop a model of incorporation choice. We argue–and document–that Delaware lures firms in-

☆ The authors thank two anonymous referees, Keith Bishop, John Coates, Martijn Cremers, Rob Daines, David Denis, John DiNardo, Jim Hines, Michael Klausner, Srini Krishnamurthy, Y.C. Loon, Guhan Subramanian, and participants at the Sixth Annual NYU/Penn Conference on Law and Finance, the 18th Mitsui Finance Symposium at the University of Michigan, the 2008 American Law & Economics Association and Conference on Empirical Legal Studies annual meetings, the 2008 New York Accounting and Finance Forum, and the Innovation, Business, and Law Colloquium at the University of Iowa for helpful comments and suggestions on earlier drafts of this article.

* Corresponding author.
E-mail addresses: MuraliJ@binghamton.edu (M. Jagannathan), acplaw@umich.edu (A.C. Pritchard).

[1] Delaware Division of Corporations, 2014 Annual Report, at 1, available at http://corp.delaware.gov/newsroom.shtml.

[2] Delaware Division of Corporations, 2014 Annual Report, at 2 (reporting that division collected $927.8 million dollars in fiscal year 2014 and accounted for 26% of the state's general fund).

http://dx.doi.org/10.1016/j.jbankfin.2016.10.008
0378-4266/

tent on growth, which has important implications for governance. Growth firms face a greater risk of securities fraud class actions and are also more likely be involved in mergers, which may also attract lawsuits. Consequently, directors of growing firms may prefer Delaware's predictable courts and surer protection against personal liability. The downside of liability protections, however, is that they may reduce the incentive of directors to monitor management. Cary (p. 686) notes in particular Delaware's director-friendly standard regarding the duty of care and indemnification. Since Cary wrote his famous article, Delaware's duty of care standard has only been further diluted.

We document that the corporate governance of Delaware firms, including pay and service on multiple boards, differ from that of non-Delaware firms. Consistent with Delaware directors being in higher demand, we find that they are paid more and hold more directorships. They also have a shorter tenure than directors of non-Delaware firms. Delaware firms also have higher institutional and block ownership than other firms, which does not suggest weaker monitoring in these firms. We find that the governance of Delaware firms continue to be significantly different from that of propensity score matched non-Delaware firms, although there is no clear pattern suggesting that it is weaker.

Having shown that Delaware firms differ in their financial and governance characteristics, we examine the relation between Delaware incorporation and the likelihood of forced CEO turnover. Cary and other race-to-the-bottom adherents argue that Delaware encourages lax monitoring, which suggest that Delaware boards will be less likely to fire CEOs. Overall, we find that Delaware incorporation is associated with higher rates of forced turnover. This relation holds when Delaware firms are compared to propensity score matched control firms. We also find that Delaware firms are more likely to force out CEOs even without obvious poor performance. Overall, our results do not support the argument that Delaware CEOs are more entrenched than other CEOs.

We proceed as follows. Section 2 compares Delaware's corporate law with that of other states and explores how those differences may appeal to firms with particular financial characteristics. Section 3 explores the relation between the choice of incorporation and firms' financial and governance characteristics. Section 4 presents our analysis of forced CEO turnover. We conclude with a discussion of our results in Section 5.

2. State of incorporation and firm characteristics

Does Delaware corporate law differ in a way that is likely to appeal to firms with particular financial characteristics? We argue that growth firms may prefer Delaware law because it facilitates mergers and offers directors sure protections against liability, which may be relevant to the monitoring provided by Delaware directors. There is some evidence in the prior literature to support the argument that Delaware attracts growth firms. Daines (2001), for example, finds that Delaware firms have a higher Tobin's *Q*. His finding is consistent with Heron and Lewellen (1998), who find that reincorporating firms (primarily to Delaware) have higher market-to-book ratios, invest more in R&D, and are larger, relative to firms incorporated in other jurisdictions.

2.1. Facilitating acquisitions & discouraging takeovers

One source of Delaware's comparative advantage may relate to facilitating corporate combinations. Romano (1985) finds that firms are likely to reincorporate in Delaware before committing to a program of mergers and acquisitions. Delaware, with its doctrine of "independent legal significance," gives corporations flexibility in structuring transactions. This doctrine takes on practical importance in allowing acquiring corporations to avoid shareholder votes and appraisal rights in most circumstances. Celikyurt et al. (2010) show that newly public firms make acquisitions at a very rapid pace, so Delaware's voting rules may be attractive for companies choosing their incorporation status at the IPO stage (the typical time for reincorporation), particularly if they anticipate rapid growth after going public. On the flip side, Daines (2001) presents evidence that firms are also more likely to be acquired if they are incorporated in Delaware. By contrast, more stable firms that plan to continue with an existing business plan rather than growing through combination would garner less benefit from reincorporating in Delaware and therefore would see less reason to pay the additional expense of Delaware incorporation.

Consistent with firms having a stable business plan eschewing Delaware, both Subramanian (2002) and Bebchuk and Cohen (2003) find that states that have adopted anti-takeover statutes have more success in retaining the incorporations of firms headquartered there. It is possible that insulation from hostile takeover may also insulate boards from shareholder pressure relating to the firm's underperformance. Kahan (2006), however, after controlling for other factors that might influence choice of incorporation–in particular liability protections (discussed below)–finds no evidence that firms are likely to incorporate in states with anti-takeover statutes. Moreover, hostile takeovers have faded from significance during our sample period (Hartzell etal., 2004). In any event, Delaware's corporate code has adopted an intermediate position with respect to anti-takeover provisions, so firms bent on discouraging takeovers would be better insulated in states with more draconian legislative countermeasures, such as Georgia, Ohio, Pennsylvania, Maryland, and Virginia.[3] In Delaware, the validity of the poison pill is firmly established,[4] although there are limits on the type of pill that can be adopted; Delaware courts have held invalid dead hand and no hand pills.[5] Thus, Delaware firms are not defenseless, but it is clearly not leading a race to the bottom in antitakeover protections.

2.2. Liability protection

Delaware may appeal to firms that anticipate greater exposure to shareholder lawsuits by offering liability protection to officers and directors. Moodie (2004) documents that Delaware reincorporations surge after Delaware adopts liability protections for directors. When the Delaware Supreme Court did the unthinkable in *Smith v. Van Gorkom*[6] — holding TransUnion's directors personally liable in connection with the company's acquisition — the Delaware legislature quickly restored equilibrium by allowing corporations to eliminate money damages for duty of care violations in their charters (Del. Gen. Corp. L. § 102(b)(7)). The Delaware legislature's swift response actually accelerated reincorporations to Delaware (Moodie, 2004), particularly from California (Netter and Poulson, 1989). The lawyers who advise officers and directors are also likely to find liability concerns salient, and lawyers are the most common instigators of reincorporation decisions (Romano, 1985; Daines, 2001).

[3] Pennsylvania, Georgia, and Virginia appear to authorize "dead hand" or "slow hand" pills, which may be the functional equivalent of a staggered board. AMP Inc. v. Allied Signal Inc., 19987 U.S. Dist. Lexis 15617 (upholding slow hand pill under Pennsylvania law); Ga. Code Ann. § 14-2-624(d); Va. Code Ann. § 13.1-646. Ohio and Pennsylvania have statutes that force disgorgement of short-term gains by hostile bidders (Ohio Rev. Code Ann. §1707.043; 15 Pa. Cons. Stat. §§2571-2575.); Massachusetts imposes classified boards on companies by statute (Mass. Gen. Laws Ann. Ch. 156B, § 50A) and Maryland allows boards to adopt an effective classified board structure without shareholder authorization (Md. Code Ann., Corps. & Ass'ns §3-803).

[4] Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (Del. 1995).

[5] Quickturn Design Sys., Inc. v. Mentor Graphics Corp., 721 A.2d 1281 (Del. 1998).

[6] 485 A.2d 858 (Del. Sup. Ct. 1985).

Cary and other race-to-the-bottom critics worry that liability protections may encourage lax monitoring by Delaware boards. Nonetheless, investors apparently favor this motivation for reincorporation: Heron and Lewellen (1998) find positive abnormal stock returns for firms reincorporating for the purpose of obtaining liability protections for directors. This reaction suggests that shareholders: (1) recognize the role of such protections in attracting outside directors, and (2) are skeptical of arguments that shareholder suits encourage active monitoring by directors. The comparative advantage provided by liability limits is enduring: Kahan (2006) finds that states that have not adopted a liability limitation are significantly less likely to retain firms headquartered in their states.

Corporate officers and directors face liability from two primary sources: (1) breach of fiduciary duty under state corporate law; and (2) liability under federal securities law, which may arise in either an SEC enforcement action or in a private class action. The exposure created by federal liability is considerably greater than that created by state law. State law can directly insulate officers and directors from state law liability, and indirectly–through indemnification–from federal law liability.

Under the corporate law of virtually every state, the combination of the business judgment rule and stringent demand requirements means that directors of public companies face little prospect of being held personally liable for their acts as directors (Black et al., 2006). Notwithstanding that low probability of liability, directors may nonetheless view the possibility of being personally sued (a much greater, and still unpleasant, likelihood) as a concern. Suits for breach of fiduciary duty are common only in connection with mergers and acquisitions (Thompson and Thomas, 2004). These suits typically allege that the directors have failed to exercise due care in selling the company or neglected to disclose all of the relevant facts. Thus, state corporate liability is an important exposure only in connection with mergers and acquisitions, and even then, only for directors of the target corporation. Delaware law provides strong assurances to directors that they will not be held personally liable in such suits.

State law limits on liability for breaches of fiduciary duty cannot bar federal securities liability, which carries liability exposure orders of magnitude greater than state law. For those claims, officers and directors must rely on indemnification and D&O insurance. Recklessness is the standard for liability under Rule 10b-5 of the Securities Exchange Act, the principal basis for federal securities claims in private class actions. Delaware allows for indemnification if the officer or director reasonably believe that their conduct was "not opposed" to the best interest of the corporation (Del. Gen. Corp. L. § 145(a)), so officers and directors can be confident of indemnification for federal securities liability absent evidence of egregious misconduct. Moreover, Delaware law is particularly generous on indemnification in other respects. Defense expenses can be a considerable burden for an individual. Officers and directors of Delaware corporation who prevail in a lawsuit against them, "on the merits *or otherwise*" have a statutory guarantee of indemnity from the corporation for the expense of their defense, (Del. Gen. Corp. L. § 145(c) (emphasis added)). Delaware also requires indemnification for partial success.[7] These statutory guarantees are critical because they cannot be rescinded by successor boards if an officer or director is ousted, a common occurrence in the wake of a corporate scandal. Moreover, they protect directors against SEC demands to preclude indemnification.[8]

To be sure, differences in indemnification can be muted by D&O insurance policies, which go beyond indemnification in the range of conduct that can be covered. Such policies are universal for public companies, but they are subject to contractual exclusions and coverage limits that may leave officers and directors vulnerable. Of particular significance in connection with securities claims, insurers are unwilling to write policies in excess of $300–$400 million, a limit which is exceeded by several settlements each year, and smaller companies typically have much lower policy limits. For directors facing parallel class actions and SEC enforcement actions, legal expenses can quickly burn through a substantial percentage of the policy limits. Moreover, the contractual exclusions in D&O policies provide fodder for potential coverage disputes with the insurer. These limitations mean that officers and directors of companies that may face securities lawsuits need to worry about both indemnification and insurance.

Which companies, and which officers and directors, need to be most concerned with liability exposure in class actions and derivative suits? With respect to state law liability, it is directors of companies that anticipate the possibility of being acquired. As noted above, Daines (2001) finds that firms incorporated in Delaware are significantly more likely to receive a takeover bid and to be acquired. For federal securities law liability, Johnson et al. (2007) show that lawsuit targets tend to be companies with larger market capitalization, more volatile stock prices, and higher share turnover. Plaintiffs' lawyers also target firms in industries that are R&D intensive with high variability of outcomes, such as the high tech and pharmaceuticals sectors. Daines (2001) finds a significant positive correlation between R&D expenditures and incorporation in Delaware. CEOs are commonly named as defendants in securities class actions, as they frequently act as a spokesman for the company, thereby exposing themselves to direct liability. Outside directors have less exposure, but they can be on the hook for SEC filings, particularly registration statements for public offerings. (Recall that reincorporation decisions are typically made just prior to the IPO.) Thus, protection against liability may be a factor allowing Delaware firms to attract executives and directors, particularly if the firms have volatile stock prices and high share turnover. Race-to-the-bottom critics, however, worry that protecting directors against liability may encourage lax monitoring by directors. We test that hypothesis in the analysis that follows.

3. Incorporation choice and governance

In Section 2, we predict that growth firms may incorporate in Delaware. The literature has long recognized that the monitoring and advising needs of the firm vary with its characteristics (Fama and Jensen, 1983; Hermalin and Weisbach, 2003; Linck et al.,2008; Coles et al., 2008). If Delaware does attract growth firms, the governance of firms incorporating there may reflect those needs. But does Delaware attract firms with governance that is different from firms incorporated in other states? In this section, we explore whether Delaware firms differ in their financial and governance characteristics. We first document the financial characteristics of companies incorporating in Delaware and compare them with those of firms incorporated in other jurisdictions. We then examine the differences in governance between Delaware incorporated firms and other firms.

[7] See Merrit-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138 (Del. Sup. Ct. 1974).

[8] The importance that Delaware places on indemnification rights – and the responsiveness of the Delaware legislature to any threats to the protections that it affords directors – is highlighted by *Schoon v. Troy Corp*., 948 A.2d 1157 (Del. Ch. 2008). In *Schoon*, the Delaware Chancery Court surprised many practitioners when it held that a corporate board could eliminate advancement rights to a former director with whom they had a legal dispute by amending the corporation's by-laws. After the Delaware Supreme Court declined to hear the case, *Bohnen v. Troy Corp*., 962 A.2d 916 (2008), the Delaware legislature quickly stepped to overturn the decision – approximately one year after the original decision, DGCL § 145(f) (providing that directors' indemnification and advancement rights could be eliminated retroactively only if the rights explicitly allow for such modification) (adopted April 2009).

Table 1
Reincorporations: summary statistics
Table below presents frequency of firms that reincorporate after their IPO. Reincorporations during the years 1992–2009 are identified primarily from Factiva news searches and then verified with information in SEC filings. Reincorporations from and to a foreign country are deleted from the sample. Also deleted are firms that do not have a CRSP share code of 10 or 11.

Panel A: Summary of reincorporations			
Number of reincorporations		643	
Moving to DE from		456	
	CA	158	
	NY	48	
	NV	34	
	CO	34	
From CA to non-DE states		7	
From DE		128	
Initial state of incorporation	Final state of incorporation	Data in COMPUSTAT prior to reincorporation	Data in COMPUSTAT after reincorporation
CA HQ firms			
CA	DE	54	105
Not CA	DE	19	29
CA	Not DE	0	0
DE	Not CA	3	4
DE	CA	1	2
Not DE	CA	1	1
NOT DE/CA	Not DE/CA	1	1
	Total CA HQ firms	**79**	**142**
Non-CA HQ firms			
All	DE	128	194
All	CA	0	0
DE	Not CA	56	85
Not DE	Not DE	22	23
	Total Non-CA HQ firms	**206**	**302**

3.1. Sample description

Our primary sample draws on the Execucomp data set, which provides data on S&P 1500 firms ("Execucomp sample"). Consequently, our sample firms are larger than the average public company. We limit our sample to firms with CRSP share codes of 10 or 11. We also exclude firms incorporated in foreign jurisdictions. Accounting data come from Compustat. We get all returns measures and the delisting codes from CRSP. Governance variables are from Execucomp and IRRC. Information about acquirers and targets comes from SDC. We provide variable definitions in Appendix I.

To supplement the Execucomp sample described above, we construct an additional sample consisting of public companies changing their state of incorporation from 1992 to 2009 ("Reincorporation sample"). We initially identify the potential sample of reincorporations using news searches in Factiva, changes in incorporation in historical quarterly Compustat, changes in incorporation from one year to the next in Compact Disclosure (till 2004) and the Edgar text search engine (2007–2009). Only reincorporation proposals that are approved by shareholders and can be verified using SEC filings are included in the sample. Reincorporations to or from a foreign country are excluded from the sample. We hand-collect governance data for the reincorporating firms from Edgar, and hence this data is mostly not available for incorporations prior to 1996.

This Reincorporation sample, although smaller, allows us to focus on firms that have made the incorporation choice relatively recently. On the other hand, because most firms choose to reincorporate in Delaware just prior to their IPO, the Reincorporation sample may not be representative of firms choosing Delaware. Thus, the Execucomp sample gives us a much broader picture of the implications of incorporation choice than our Reincorporation sample, which does not capture reincorporations before the IPO.

Table 1 summarizes the reincorporation sample. The most common movers to Delaware are firms previously incorporated in California. In contrast, there is no particular state that dominates among firms that reincorporate from Delaware.

We also reviewed the rationales for reincorporation offered in the proxy statements filed with the SEC by companies in the Reincorporation sample (Appendix II). The most commonly cited reasons for reincorporating to Delaware were predictability and the ability to attract directors, consistent with our arguments above relating to liability. (California, in particular, may offer directors less protection against liability.) For firms leaving Delaware (a much smaller number), the most commonly cited reason, and often the only stated reason, was to save money on franchise fees. The savings on franchise fees are small. For 85 firms reincorporating from Delaware with stated savings, the mean (median) annual savings in franchise fees was $87,685 ($67,000).

3.2. Descriptive statistics: financial characteristics

Table 2 provides descriptive statistics on the financial characteristics of the firms. For the Execucomp sample we compare firms incorporated in Delaware with those incorporated elsewhere. For the Reincorporation sample, we compare firms reincorporating in Delaware with those reincorporating elsewhere (typically the state in which their headquarters is located).

The firms incorporated in Delaware have a lower book to market ratio; this difference is considerably more pronounced for the Reincorporation sample. The firms choosing Delaware invest substantially more in R&D. For the Execucomp sample, the Delaware firms are fewer years away from their IPO, but there is no difference for the Reincorporation sample. Overall, it appears that firms opting for Delaware have characteristics commonly associated with growth firms, while the firms that reincorporated away from Delaware during the sample period are not growth firms, despite their relative youth. Turning to characteristics commonly associated with potential exposure to lawsuits, volatility of stock returns is greater for the firms opting for Delaware, as is stock turnover. In addition, the firms reincorporating to Delaware tend to be in industries with a higher proportion of takeover activity.

Table 2
Characteristics of Delaware firms.
Firm characteristics are summarized in the table. Columns (1) and (2) present the mean (median) characteristics of firms in the Execucomp sample. Columns (3) and (4) summarize the mean (median) characteristics of reincorporating firms in the year prior to their reincorporation. Reincorporations during the years 1992–2009 are identified primarily from Factiva news searches and then verified with information in SEC filings. Reincorporations from and to a foreign country are deleted from the sample. In Panel B, we report the characteristics of Delaware firms and matched non-Delaware firms based on propensity scores. Propensity scores are estimated using a Probit regression with all the variables mentioned in this table, except for Firm Age. Variable definitions are in the Appendix. 't' and 'z' values presented are from 2-sample *t*-tests and Wilcoxon rank sum tests.

Panel A: firm characteristics

	Execucomp sample			Reincorporation sample		
	Delaware	Other firms	t-values (z-values)	Firms to DE	Firms from DE	t-values (z-values)
	(1)	(2)	(2)–(1)	(3)	(4)	(4)–(3)
Total assets	11,656.4	9410.51	−3.33	544.66	703.83	0.67
	(1108.93)	(1235.25)	(3.03)	(56.68)	(159.79)	(4.36)
Book to market	0.491	0.531	7.72	0.446	0.800	3.66
	(0.40349)	(0.465)	(14.31)	(0.337)	(0.598)	(4.41)
R&D (%)	5.65	3.04	− 17.31	23.70	3.70	−−5.30
	(0)	(0)	(− 18.83)	(0.98)	(0.00)	(− 4.89)
Volatility (%)	12.55	(10.62)	−21.87	20.17	14.59	− 4.63
	(10.726)	(9.11)	(− 24.33)	(17.44)	(12.67)	(− 4.34)
Takeover activity (%)	5.89	4.57	−9.80	8.81	4.04	− 4.93
	(1.81)	(1.23)	(− 11.55)	(4.44)	(1.16)	(− 4.09)
Firm age	18.5486	25.7406	31.37	5.47	5.47	−0.00
	(12.6438)	(22.45)	(37.64)	(4.03)	(3.70)	(− 0.13)
N	16,751	12,047		252	87	

Panel B: propensity matched sample

	Delaware	Control firms	t-values (z-values)
Total assets	12,128.2	11,453.2	(2)–(1)
	(1196.84)	(1209.17)	−0.39
Book to market	0.494	0.493	− 0.17
	(0.408)	(0.428)	3.37
R&D (%)	5.23	5.10	−0.85
	(0)	(0)	(− 3.65)
Volatility (%)	12.32	11.43	−10.83
	(10.57)	(9.82)	(− 13.35)
Takeover activity (%)	5.71	6.14	2.81
	(1.75)	(1.71)	(− 0.43)
Firm age	19.96	26.18	29.66
	(13.74)	(22.06)	(34.51)
N	**15,364**	**15,364**	

3.3. Multivariate analysis: financial characteristics

We next look at the incorporation decision in a multivariate framework. We use probit regressions with the decision to reincorporate in Delaware as the dependent variable. For the Execucomp sample, this variable is coded as 1 for firms incorporated in Delaware and 0 if they are incorporated elsewhere. For the regressions using the Reincorporation sample, the dependent variable is coded as 1 for firms reincorporating in Delaware and 0 for firms leaving Delaware to incorporate elsewhere. We use the log of Total Assets, R&D, Book to Market, Takeover Activity, and Stock Volatility as our independent variables. The results are presented in Table 3.

For the regression using the Execucomp sample, the coefficients for the log of Total Assets, Takeover Activity, Stock Volatility, and R&D all positive and significant. This result supports the hypotheses that firms choose Delaware incorporation because of motivations relating to mergers and acquisitions and potential liability.

The second set of regressions compares firms reincorporating in Delaware with those abandoning Delaware incorporation to reincorporate elsewhere. The dependent variable for this regression is coded as 1 if the firm retains its Delaware incorporation and 0 if the firm reincorporates in a state other than Delaware. The results are somewhat weaker, consistent with a considerably smaller sample size. We see that smaller firms are less likely to reincorporate to Delaware (or are more likely to leave). Firms with a lower book to market ratio are significantly more likely to retain their Delaware incorporation, signifying that firms leaving Delaware have limited growth potential. For these firms, the savings in franchise fees from leaving Delaware may be significant. The coefficient for Takeover Activity is also positive, consistent with firms reincorporating to Delaware to avail themselves of its flexible rules relating to mergers and acquisitions.

3.3.1. Propensity score matching

Since firm characteristics are systematically different in Delaware, it is difficult to disentangle the effect of firm characteristics from Delaware incorporation on firm governance. To identify the incremental effect of Delaware incorporation, we employ the propensity score matching approach. We match peers for Delaware firm using the estimates from model (1) of Table 3 (discussed above). We compute the predicted probability of incorporating in Delaware, and for Delaware firm-year observation, we identify the non-Delaware firm-year observation with the closest predicted probability (propensity score). We select peers with replacement without conditioning for calendar years. We require that the matched peers have predicted probability within 0.1 of that of the Delaware firm.

Overall, we appear to have good matches. The mean (median) difference in predicted probability between Delaware firms and their matched peers is 4.243E−6 (2.727E−8). Panel B of Table 3 summarizes the differences in characteristics between the two groups. Stock Volatility appears to be different between the two

Table 3
Incorporation choice.
Table presents results from probit models of Delaware incorporation. Model (1) uses the Execucomp sample. In these regressions, Delaware is a dummy variable that takes the value of '1' for if the firm is incorporated in Delaware, and zero otherwise. Model (2) used the reincorporation sample. Clustered Standard errors, clustered at the firm level, are shown in parentheses. In Model (2), the dependent variable "Delaware" takes the value of one if the firm incorporates to Delaware and zero if it reincorporates to another US state from Delaware. *, **, *** represent statistical significance at the 10%, 5% and 1% levels, respectively.

Dependent variable: delaware incorporation				
	Execucomp sample		Reincorporation sample	
	Probit	Marginal effects	Probit	Marginal effects
	(1)		(2)	
Log (total assets)	0.050***	0.020***	−0.234**	−0.019*
	(0.016)	(0.006)	(0.101)	(0.012)
Book to market	−0.147***	−0.058***	−0.552**	−0.0455
	(0.038)	(0.015)	(0.232)	(0.031)
Takeover activity	0.482***	0.189***	6.638**	0.548
	(0.123)	(0.048)	(3.019)	(0.364)
Stock volatility	3.472***	1.361***	3.089	0.255
	(0.387)	(0.152)	(2.351)	(0.254)
R&D	0.540**	0.212**	4.148	0.342***
	(0.236)	(0.092)	(2.605)	(0.072)
Constant	−0.540***		0.535	
	(0.134)		(1.054)	
Year dummies	Yes		Yes	
Observations	24,139	24,139	307	
Pseudo R^2	0.0251		0.2143	

groups, but otherwise, there is little difference between the two groups. Of course, other variables may affect both propensity scores and turnover.

3.4. Descriptive statistics: governance characteristics

In the previous section, we saw that Delaware attracts growth firms. These firms may have different governance needs, and consequently, the governance structure of Delaware incorporated firms may systematically differ from firms incorporated elsewhere. To control for this endogeneity and examine whether Delaware affects the likelihood of CEO termination, we match each Delaware firm to a non-Delaware incorporated firm using the propensity scores discussed in Section 3.3.1.

In Table 4, we compare the governance characteristics of our sample firms. Whether compared to other firms overall or to propensity-score matched peers, there are significant governance differences between Delaware firms and other firms. The boards of Delaware firms are on average somewhat smaller for both the Execucomp and Reincorporation samples. This is consistent with the evidence in Coles et al (2008) that R&D intensive firms may value firm specific knowledge more than other firms. On the other hand, outside directors of Delaware firms in our samples serve on a significantly greater number of boards than do the directors for the firms in other jurisdictions, which may stretch their attention.[9] It also suggests, however, that Delaware firms are able to attract directors who have greater demand for their services as a result of Delaware's protections against liability. Supporting this theory of stronger demand, outside directors of the Delaware firms in our sample receive larger retainers**.** We note the average tenure of Delaware directors is lower than for firms incorporated in other states; the directors themselves do not appear to be entrenched.

We also present evidence on shareholder influence. Mansi et al. (2009) and Daines (2002) suggest that one motive for incorporating in Delaware is to attract institutional investors.[10] Consistent with this observation, the Delaware firms in our sample have significantly greater institutional ownership, suggesting that their boards may face greater external scrutiny, which may translate into greater pressure to terminate underperforming CEOs.

Finally, we note that the fraction of Delaware firms in our Execucomp sample that are sued in a securities fraud class action is higher than for firms incorporated elsewhere. That is consistent with the personal liability protection motive for incorporating in Delaware noted in Section 2.

Before we model the governance characteristics mentioned above, we also summarize CEO characteristics that may be relevant to the termination decision by the board. We see that a smaller proportion of Delaware firms in the Execucomp sample are headed by a CEO who is also a firm founder (Founder CEO); there is no difference in proportion for the Reincorporation sample. We include this variable in our regression when we model CEO turnover.

The number of directorships held by the CEO might be thought of as an outside assessment of the CEO's strategic skills, or as a proxy for valuable contacts. In a succession process, the promotion of the CEO to the additional post of Chairman may depend on his prior performance. Combining the CEO and Chair position may reflect either greater bargaining power wielded by outsider candidates to become CEO or a higher quality CEO candidate. Once established, CEOs may have greater influence if they also serve as Chair. In any event, combining those positions is likely to enhance the CEO's job security (Goyal and Park, 2002). In our Execucomp sample, a slightly smaller percentage of Delaware firms combine the position of CEO and Chair relative to firms incorporated in other jurisdictions. Delaware CEOs have shorter average tenure, al-

[9] We do not hand-collect the multiple directorship information for reincorporating firms.

[10] This point is supported by anecdotal evidence from corporate lawyers, who say that they counsel clients to reincorporate in Delaware before their IPOs because Delaware law provides a known quantity for investors attempting to evaluate the firm (Klausner, 1995). Delaware law is predictable because of the large body of precedents to which its courts can look in deciding cases and Delaware's experienced and expert judges who sit on its Court of Chancery (Fisch, 2001). Delaware incorporation allows investors evaluating firms to economize on information costs, which may be important if they have a large number of portfolio companies.

Table 4
Governance characteristics.
Table summarizes the board and other monitoring characteristics of firms. Means (medians) of the Execucomp sample are presented in Columns (1) and (2), and that of the reincorporation sample is presented in Columns (3) and (4). In Columns (5) and (6) we compare the governance characteristics of Delaware firms with the sample of matched non-Delaware firms with the closest propensity scores. We obtain information on Director Retainer and CEO tenure from Execucomp, Institutional Ownership information from Thomson Reuters, and the rest of the governance data from IRRC. Lawsuit data are from Securities Class Action Clearinghouse. The sample period is from 1993 to 2009, but IRRC measures are available only from 1996. Variable definitions are in the appendix. 't' and 'z' values presented are from 2-sample *t*-tests and Wilcoxon rank sum tests comparing Delaware incorporated firms with other firms.

	Execucomp firms			Reincorporating firms			Propensity score matched firms		
	Delaware	Other firms	t-values (z-values)	Firms to DE	Firms from DE	t-values (z-values)	Delaware	Control firms	t-values (z-values)
	(1)	(2)	(2)–(1)	(3)	(4)	(4)–(3)	(5)	(6)	(6)–(5)
Board size	9.24	11.22	3.73	6.78	7.87	2.11	9.25	11.62	4.11
	(9)	(10)	17.57	7	7	(2.01)	(9)	(10)	(17.55)
Directorships	0.99	0.88	−9.58	0.61	0.41	1.71	0.99	0.94	−4.15
	(0.90)	(0.80)	(−9.76)	(0.5)	(0.25)	(−1.64)	(0.89)	(0.83)	(−5.22)
Director retainer	25.50	22.27	−7.54				25.70	22.77	−7.38
	(24)	(20)	(−16.24)				(24)	(20)	(−15.71)
Director tenure	7.07	8.17	18.99	4.79	6.35	1.80	7.11	8.03	18.29
	(6.60)	(7.66)	(20.05)	(4.0)	(5.18)	(1.62)	(6.62)	(7.57)	(19.48)
Institutional ownership (%)	64.25	58.44	−21.32	30.25	28.12	−4.93	64.46	59.06	−21.87
	(66.99)	(59.73)	(−22.21)	(19.03)	(26.96)	(−4.09)	(67.22)	(60.59)	(−22.71)
CEO directorships	0.564	0.606	2.79	0.14	0.06	−1.25	0.573	0.641	4.87
	(0)	(0)	(2.25)	(0)	(0)	(−0.48)	(0)	(0)	(4.25)
CEO tenure	7.43	8.17	7.68	7.01	8.80	1.09	7.68	8.29	6.79
	(5.17)	(5.83)	(7.43)	4.46	7.28	(1.38)	(5.59)	(6.00)	(7.24)
CEO age	54.71	55.36	4.06				55.15	55.03	−1.34
	(55)	(55)	(7.10)				(55)	(55)	(−1.87)
Founder CEO	0.216	0.241	χ^2=23.18	0.286	0.287	χ^2=0.001	0.213	0.244	χ^2=41.45
CEO chair	0.3525	0.3377	χ^2=4.08				0.3540	0.3393	χ^2=4.67
Lawsuit	0.0343	0.0238	χ^2=24.21				0.0341	0.0267	χ^2=14.58

though the difference is insignificant for the Reincorporation sample. Shorter tenure suggests less entrenchment. Parrino (1997) and Jenter and Lewellen (2014) also document that CEOs with shorter tenure are more likely to be forced out.

3.5. Multivariate analysis: governance characteristics

In this section we assess the differences in governance characteristics of Delaware incorporated firms and other firms more rigorously. We model each of the governance variables separately using OLS or Probit (for class actions). We include an indicator variable for Delaware incorporation, our main variable of interest, as an independent variable in all regressions. We present the results in Table 5. Panel A presents the results using the whole Execucomp sample; Panel B presents results comparing Delaware firms with their matches using propensity scores.

We begin with our regressions for director characteristics. The first regressions use the retainer for outside directors as its dependent variable. For our independent variables, we include the log of Total Assets because directors of larger firms are likely to be paid more. We use book to market and firm age to proxy for the firm's advising needs. We also include an indicator variable, Post-SOX, which corresponds to the years 2002–2009 in our sample, when listing requirements mandated by the Sarbanes-Oxley Act circumscribed governance choices. Dah et al. (2014) document that firms' turnover performance sensitivity decreases post-SOX for firms that reduce director independence. The second regression uses average director tenure as the dependent variable. The third regression uses the average number of board seats held by outside directors as its dependent variable. Ferris et al. (2003) present evidence that firm performance affects the number of directorships held by an individual, which they call the "reputation effect." Such directors may be particularly sensitive to performance if it affects their reputation. Critics, however, might contend that highly paid directors are being paid for acquiescence, and busy directors may be stretched too thin (Fich and Shivdasani, 2006).

The Delaware coefficient is positive and significant for the director retainer and directorships regressions, but negative for the director tenure regression, even when we use the propensity-score matched sample. Changing the state of incorporation to Delaware from other states increases director pay by about $2800 and increases outside directorships of board members by about 0.06 directorships. When compared to their unconditional averages of about $24,000 and 0.94 directorships, the effects also appear to be economically meaningful. This supports the notion that Delaware directors have greater demand for their services. The directors have not served longer, however, relative to their peers serving on boards incorporated elsewhere. Incorporating in Delaware lowers director tenure by about 0.73 years. We note that individuals who serve on multiple boards are most likely to be concerned about the potential for personal liability because each additional board membership increases the threat of liability. The significant negative coefficient for the Post-SOX variable suggests that service on multiple boards has diminished since 2002.

Our next set of regressions looks at institutional ownership, which may also provide external pressure to terminate an underperforming CEO. We run regressions for both the number of blocks and percentage of institutional ownership. Our model predicting institutional ownership is based on the institutional ownership model specification in Gompers and Metrick (2001). They use four variables to proxy for institutions' preference to invest in "prudent" stocks: firm age, dividend yield, S&P membership, and stock-price volatility. They also use firm size and market to book to proxy for institutions' preference to own liquid stocks. Since institutions appear to prefer "momentum" stock, the prior year's stock return is also used as control variable. We omit S&P membership from our list of independent variables, since our sample consists of relatively large firms. The Delaware coefficient is positive and significant in explaining the number of blocks and institutional ownership. The marginal effect of Delaware incorporation increases institutional ownership by 3.37% (unconditional average of 61.8%).

Table 5
Governance characteristics of Delaware incorporated firms
Table presents results from regressions predicting measures of governance based on Delaware incorporation. Panel A presents results of OLS (Probit when modeling class action) regressions. The sample consists of all Execucomp firm years from 1993–2009. We obtain information on Director Retainer and CEO tenure from Execucomp, Institutional Ownership information from Thomson Reuters, and the rest of the governance data from IRRC. IRRC measures are available only from 1996. Lawsuit data are from Securities Class Action Clearinghouse. In these regressions, Delaware is a dummy variable that takes the value of '1' if the firms is incorporated in Delaware, and zero otherwise. Clustered standard errors are in parentheses. Variables are defined in the appendix. In Panel B, we present the regressions using the Delaware sample and control firms with the closest propensity score. *, **, ***, represent statistical significance at the 10%, 5% and 1% levels, respectively.

Panel A: OLS/ probit regressions

	(1) Director retainer	(2) Director tenure	(3) Directorships	(4) Number of blocks	(5) Institutional ownership	(6) Class action	(7) CEO tenure
Delaware	3.123***	−0.834***	0.109***	0.198***	3.166***	0.00143	−0.870***
	(0.488)	(0.149)	(0.0270)	(0.0371)	(0.635)	(0.00218)	(0.279)
Log (total assets)	3.053***	−0.0944**	0.148***	−0.169***	1.078***	0.0132***	
	(0.143)	(0.0433)	(0.00744)	(0.0120)	(0.224)	(0.00106)	
Book to market	0.689	0.00719	−0.156***	0.652***	−2.336***	−0.0187***	−0.222
	(2.084)	(0.137)	(0.0231)	(0.0439)	(0.698)	(0.00303)	(0.224)
Years since IPO	0.0548***	0.0352***		0.000903	0.0673***		−0.0171***
	(0.0121)	(0.00400)		(0.00113)	(0.0197)		(0.00600)
Stock volatility				−2.375***	−81.66***	0.393***	
				(0.273)	(4.503)	(0.0300)	
Stock turnover				0.310***	10.88***	0.0135***	
				(0.0396)	(0.650)	(0.00240)	
Dividend yield				−10.35***	−247.3***		
				(1.139)	(19.28)		
Momentum				−0.137***	0.199		
				(0.0132)	(0.200)		
CEO performance							−0.299***
							(0.0580)
Post-SOX	5.537***		−0.157***				
	(0.342)		(0.0161)				
Constant	−4.730***	7.613***	−0.0762	2.216***	45.66***	−0.127***	8.521***
	(0.930)	(0.346)	(0.0556)	(0.0951)	(1.641)	(0.00912)	(0.316)
Year fixed effects	No	Yes	No	Yes	Yes	Yes	Yes
Observations	23,086	16,016	14,122	23,687	23,687	24,173	25,969
Adj R^2	0.068	0.055	0.147	0.207	0.331	0.030	0.006

Panel B: propensity score matched sample

	(1) Director retainer	(2) Director tenure	(3) Multiple directorships	(4) Number of blocks	(5) Institutional ownership	(6) Class action	(7) CEO Tenure
Delaware	2.793***	−0.726***	0.0589**	0.182***	3.374***	0.00400	−0.852***
	(0.459)	(0.150)	(0.0281)	(0.0399)	(0.694)	(0.00308)	(0.303)
Log (total assets)	3.039***	−0.0926**	0.154***	−0.170***	1.000***	0.0124***	
	(0.137)	(0.0440)	(0.00828)	(0.0137)	(0.252)	(0.00123)	
Book to market	0.337	0.000466	−0.170***	0.649***	−3.111***	−0.0217***	−0.150
	(1.915)	(0.161)	(0.0265)	(0.0488)	(0.815)	(0.00367)	(0.271)
Years since IPO	0.0691***	0.0318***		0.00166	0.0735***		−0.0326***
	(0.0126)	(0.00420)		(0.00122)	(0.0213)		(0.00593)
Stock volatility				−2.444***	−77.64***	0.359***	
				(0.360)	(7.401)	(0.0449)	
Stock turnover				0.323***	11.05***	0.0129***	
				(0.0422)	(0.710)	(0.00320)	
Dividend yield				−9.883***	−235.9***		
				(1.259)	(21.13)		
Momentum				−0.147***	−0.0204		
				(0.0166)	(0.297)		
CEO performance							−0.515***
							(0.168)
Post-SOX	5.626***		−0.184***				
	(0.337)		(0.0205)				
Constant	−4.382***	7.545***	−0.0522	2.281***	46.47***	−0.118***	9.579***
	(0.987)	(0.364)	(0.0596)	(0.112)	(1.975)	(0.0110)	(0.438)
Year fixed effects	No	Yes	No	Yes	Yes	Yes	Yes
Observations	27,286	19,712	17,380	28,198	28,198	28,818	27,269
Adj R^2	0.082	0.047	0.161	0.203	0.323	0.027	0.010

This suggests that firms succeed in attracting institutional investors when they incorporate in Delaware.

The growth characteristics of Delaware firms imply that directors of those firms need to be concerned about liability risks, and thus, may value protections against personal liability. The next regression assesses whether Delaware firms are more vulnerable to lawsuits, using securities class actions as our measure of lawsuits. The model for securities class actions is based on Ferris et al. (2003). They use firm size to proxy for the notion that firms with "deep pockets" are more likely to be sued. We also include book to market as a proxy for growth characteristics because failing to launch new products or meet earnings expectations can be a trigger for lawsuits. Prior literature (Johnson et al., 2007) has also documented that stock price volatility and share turnover – key factors for loss causation and damages – are major determinants of lawsuits, so we include these variables in the regression.

The Delaware coefficient is insignificant, suggesting that Delaware firms are no more likely to be sued after we control for the characteristics that affect incorporation choice. This finding suggests that Delaware firms may have anticipated their greater potential exposure to lawsuit, based on their financial characteristics at the time they made their choice of incorporation. Recall from our discussion above that Delaware incorporation cannot limit the incidence of such suits, which arise under federal law; Delaware law only provides assurance that directors will not face personal liability. The race-to-the-bottom hypothesis would suggest that assurance against liability may promote laxity in monitoring. We do not find evidence to support that hypothesis, however, as Delaware firms are no more likely to be sued for securities fraud.

Finally, we examine CEO tenure. We include the stock performance of the firm during the CEO's tenure as an independent variable. We use book to market ratio to proxy for the CEO's firm-specific information. We also add firm age, however, as younger firms may be more vulnerable to mismanagement because they are less well established in their markets. The Delaware coefficient is negative and significant. Changing the incorporation to Delaware from other states decreases CEO tenure by 0.85 years, which is inconsistent with entrenchment. CEO tenure may not capture likelihood of involuntary termination, however, because it does not distinguish voluntary retirement from termination in the wake of poor performance. An analysis of how Delaware incorporation affects forced CEO turnover follows in the next section.

4. Incorporation, governance, and CEO turnover

In the previous section, we documented significant differences in governance between Delaware incorporated firms and other firms. In this section, we explore the relation between Delaware incorporation and the likelihood of CEO turnover. We begin by identifying difference in rates of turnover among jurisdictions. We show that Delaware firms terminate their CEOs significantly more frequently than the average firm in our sample. We then use a multivariate framework to test whether the Delaware incorporation reduces the likelihood of CEO termination after controlling for performance and firm characteristics.

4.1. Identifying forced CEO turnover

Execucomp provides executive names and the date they became CEO, which we use to identify CEOs and their turnover. We then use Factiva to search and classify these turnovers. Our identification of forced CEO turnover is similar to the methodology followed in the literature (see, e.g., Jenter and Kanaan (2015)). CEOs are considered to be forced out if the news article states that the CEO was fired or forced out, if there is pressure from investors calling for their ouster, if the CEO leaves because of "irreconcilable differences" with the board, if they leave to "pursue other opportunities," and if there is no reason stated but an interim CEO is appointed to succeed them and the departing CEO is less than 60 years of age. If the CEO leaves to join another firm, if they die, or if they retire, the turnovers are classified as unforced. We also look through articles published subsequent to the turnover to lower the likelihood of errors in classifying forced turnover. When it is not clear whether the turnover is forced or not, we treat the turnover as unforced. We do not include turnover due to mergers. Given the decline in hostile mergers over our sample period, however, very few incumbent CEOs leave immediately after a takeover; they are often associated with the merged firm for about a year.[11]

4.2. Turnover

We present a summary of firm, governance, and CEO characteristics at the time of turnover in Table 6. Many of the variable averages appear to be significantly different from the overall sample, likely driven by the poor performance at the time of turnover. For example, the average book to market of Delaware firms at the time of turnover is 0.63 when compared to the overall average of 0.49 presented in Table 3. Stock volatility also appears to be higher. The proportion of founder CEOs who are fired is also small. This should be expected given the typically large stakes that they own. But, in general, the difference between the characteristics of Delaware firms and non-Delaware firms appear to remain at the time of the turnover.

We present the characteristics at the time of forced CEO turnover as well as all other CEO turnover. The performance declines around forced CEO turnover are significantly lower than other turnover. The small performance declines around other departures suggests that many of them may be voluntary, validating our classification of forced CEO turnover.

We sort turnover by two measures of stock performance: (i) over the CEO's tenure or the last five years, whichever is shorter, and (ii) over the past two years (Year 0 and Year − 1). We industry adjust both performance measures (using the Fama/French 48 industry classification) to filter out exogenous industry shocks. When we stratify performance into quintiles (Table 7), we find that the forced turnover rates in Delaware incorporated firms are markedly higher than the rate for firms in other states across all performance quintiles. This consistently higher rate of turnover somewhat paradoxically suggests lower turnover performance sensitivity for Delaware firms because turnover is higher even for firms that are not performing obviously poorly. We note, however, that firms in the lowest quintile of industry-adjusted performance are most likely to terminate their CEOs, as theory would predict. There is no apparent pattern in turnover for other reasons, which further strengthens our belief that the classification of turnovers as forced is accurate.

The preceding discussion suggests that Delaware firms are more likely to terminate their CEOs and that turnover is most likely for firms in the lowest quintile of performance. In this section we use a multivariate framework to examine the relation between incorporation, firm characteristics, and the likelihood of forced turnover.

We use Forced Turnover as the dependent variable in a series of probit regressions. In the first set, performance is measured as the industry-adjusted performance of the CEO over the last five years or over their tenure, whichever is shorter. In the second set, we measure the performance as the firm's industry-adjusted performance over the last two years (Year 0 and Year−1). We present the results in Table 8. Panels A1 and A2 presents results for the Execucomp sample and Panels B1 and B2 presents the results using the Delaware firms with their propensity matched peers. In Panels A1 and B1, we do not include any interaction terms. We also directly control for firm characteristics, as well as variables interacting these characteristics with performance. We run two regressions for each measure of performance. The standard errors presented in the table account for clustering at the firm level.

We see a consistent pattern in all the panels. Delaware incorporation is associated with higher rates of forced turnover. The Delaware indicator variable is positive and strongly significant in all of the regressions. The marginal effect of Delaware on forced CEO turnover (calculated at the means) ranges from about 55 basis points to 82 basis points. As expected, the coefficient for Per-

[11] If turnovers related to takeover were included, Delaware's rate of CEO turnover is even greater when compared to other states.

Table 6
Characteristics at turnover.
Table below summarizes the firm performance and the firm, governance, and CEO characteristics at the time of the CEO turnover. The mean (medians) around forced CEO turnover are shown in the first two columns and for all CEO turnover is shown in the next two columns. 't' and 'z' values presented are from 2-sample *t*-tests and Wilcoxon rank sum tests comparing Delaware incorporated firms with other firms.

	Forced		All turnover		Difference	
	Delaware	Other firms	Delaware	Other firms	Forced	All turnover
Total assets	20,708.26	17,775.26	16,759.00	11,816.50	−0.40	−1.60
	(1010.23)	(1326.97)	(1291.75)	(1616.54)	(1.74)	(2.42)
Book to market	0.628	0.678	0.556	0.592	1.08	1.78
	(0.51)	(0.55)	(0.443)	(0.515)	(1.58)	(4.04)
R&D	0.069	0.028	0.058	0.025	−4.93	−7.42
	(0.00)	(0.00)	(0.00)	(0.00)	(−4.39)	(−7.88)
Return volatility	0.157	0.134	0.136	0.109	−3.47	−8.80
	(0.13)	(0.11)	(0.115)	(0.093)	(−3.66)	(−9.03)
Firm age	19.88	26.60	21.34	28.25	5.12	9.10
	(14.18)	(23.84)	(14.669)	(25.414)	(6.35)	(11.68)
Takeover activity (%)	5.77	4.99	5.76	4.16	−1.09	−3.93
	(2.07)	(1.60)	(2.02)	(1.18)	(−0.92)	(−4.02)
Director retainer	27.26	23.87	26.68	23.70	−2.74	−4.32
	(24.00)	(21.00)	(24.00)	(20.00)	(−2.26)	(−4.68)
Director tenure	5.94	7.28	6.62	7.81	4.62	6.87
	(5.67)	(6.83)	(6.20)	(7.43)	(4.37)	(7.00)
Directorships	0.97	0.93	1.05	0.95	−0.49	−2.53
	(0.86)	(0.93)	(1.00)	(0.86)	(−0.56)	(−2.79)
No. of blocks	2.16	2.03	2.05	1.76	−1.19	−5.01
	(2.00)	(2.00)	(2.00)	(1.60)	(−1.24)	(−5.28)
Inst. ownership (%)	60.81	58.49	62.26	57.92	−1.37	−4.85
	(64.07)	(59.84)	(64.72)	(59.76)	(−1.75)	(−5.17)
FounderCEO	0.060	0.106	0.083	0.102	χ^{2}=3.26	
CEO chair	0.46	0.36	0.32	0.26	χ^{2}=4.15	
	(0)	(0)	(0)	(0)		
CEO tenure	6.53	7.34	8.08	9.67	1.59	4.68
	(4.73)	(5.21)	(6.26)	(7.54)	(0.85)	(5.10)
CEO age	54.88	55.54	57.71	59.81	0.19	6.19
	(54.00)	(55.00)	(58)	(61)	(1.59)	(5.77)
CEO directorships	0.58	0.53	0.57	0.61	0.56	1.21
	(0.00)	(0.00)	(0.00)	(0.00)	(−0.43)	(0.76)
CEO performance (%)	−18.32	−17.78	−8.69	−8.53	0.24	0.10
	(−19.03)	(−15.71)	(−10.63)	(−8.28)	(1.75)	(3.22)
Recent performance (%)	−23.75	−23.58	−9.77	−9.87	0.07	−0.06
	(−25.31)	(−21.33)	(−14.09)	(−10.20)	(1.39)	(2.67)
Estimated lawsuit prob	0.961	0.970	0.962	0.972	0.49	NV
	(0.971)	(0.976)	(0.974)	(0.979)		

Table 7
CEO turnover frequency and firm performance.
The table presents the percentage CEO turnover each year in Execucomp firms from 1992–2009. We classify CEO turnovers into Forced turnovers and Other turnovers using news searches. We classify the firm's stock performance into quintiles and present the percentage turnover of CEOs in that quintile. CEO Performance is measured as the industry adjusted stock performance over the past five years or over the CEO's tenure, whichever is shorter. Recent Performance is the industry adjusted stock performance in year 0 and Year −1. Turnovers due to mergers are not included. The first two columns in the panel present the turnover in Delaware incorporated firms and the last two columns present the turnover in firms incorporated in other states.

	CEO performance				Recent performance			
	Delaware		Other states		Delaware		Other states	
	Forced	Other	Forced	Other	Forced	Other	Forced	Other
Lowest quintile	7.11	6.91	5.83	6.83	7.26	6.88	6.36	7.08
2	3.22	6.11	2.93	6.92	3.20	5.96	2.49	6.46
3	2.13	5.51	1.25	6.05	2.00	5.23	1.25	5.87
4	1.35	6.19	1.04	5.45	1.12	5.45	1.01	5.52
Highest quintile	1.39	5.11	0.90	4.96	1.55	6.20	0.80	5.36

formance is negative and strongly significant in all of the specifications.[12]

[12] The coefficient of performance is slightly larger in magnitude than the −0.4167 reported by Huson, Parrino, and Starks (2001), but our sample firms and the sample period are not exactly comparable. Jenter and Kanaan (2015) separate out idiosyncratic returns and industry induced stock returns and report probability of turnover at the 10th and 90th percentiles of returns. We instead report at the mean values. In the next table, we report the average marginal effect, which may be more informative of the performance turnover sensitivity of Delaware firms. Overall our numbers are comparable with their study.

Table 8
Delaware characteristics and forced CEO turnover.
The table presents results from probit regressions predicting forced CEO turnovers. Panel A presents the results using all firm-years on Execucomp from 1992 to 2009. Panel B presents the results for the Delaware firms and their matched controls obtained using propensity scores. Performance measure used in the regression is mentioned at the top of the table. CEO Performance is the industry adjusted stock performance over the past five years or over the CEO's tenure, whichever is shorter. Recent performance is the performance in Years − 1 and Year 0. In the years with forced CEO turnover, only performance till the turnover date is included in the calculation of recent performance. All other variable are as defined in the appendix.. All regressions account for clustering at the firm level, and clustered standard errors are shown in parentheses. Panels A1 and B1, we do not interact Delaware and Performance and present the marginal effects computed at the means in the next column. In Panels A2 and B2, we interact the variables with performance. The average marginal effect of performance on Delaware and other firms are shown at the bottom of these panels. Coefficients that are significant at the ten, five, and one percent levels are shown with *, **, and ***, respectively.

Panel A1: execucomp firms

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	CEO performance				Recent performance			
	Probit	Marginal effects	Probit	Marginal effects	Probit	Marginal effects	Probit	Marginal effects
Delaware	0.146***	0.00823***	0.107***	0.00578***	0.142***	0.00753***	0.106***	0.00548***
	(0.0369)	(0.00216)	(0.0377)	(0.00203)	(0.0375)	(0.00216)	(0.0379)	(0.00198)
Performance	−0.624**	−0.0358***	−0.461**	−0.0252**	−0.783***	−0.0423***	−0.611***	−0.0320***
	(0.266)	(0.0136)	(0.214)	(0.0110)	(0.269)	(0.0116)	(0.228)	(0.0104)
Log assets			0.0360***	0.00197***			0.0347***	0.00182***
			(0.0110)	(0.000599)			(0.0110)	(0.000577)
Book to market			0.201***	0.0110***			0.186***	0.00971***
			(0.0381)	(0.00228)			(0.0380)	(0.00226)
Volatility			2.404***	0.131***			2.274***	0.119***
			(0.287)	(0.0181)			(0.338)	(0.0221)
R&D			−0.151	−0.00825			−0.166	−0.00868
			(0.158)	(0.00859)			(0.159)	(0.00831)
Post Sox			−0.0159	−0.000867			−0.00874	−0.000457
			(0.0355)	(0.00194)			(0.0358)	(0.00187)
Constant	−2.060***		−2.686***		−2.088***		−2.676***	
	(0.0363)		(0.0998)		(0.0429)		(0.0993)	
Observations	26,001		24,149		25,995		24,149	
Pseudo R^2	0.0262		0.0474		0.0458		0.0617	

Panel A2: execucomp firms – probit regressions with interaction terms

	CEO performance			Recent erformance		
	(1)	(2)	(3)	(4)	(5)	(6)
Delaware	0.269***	0.219***	0.201***	0.289***	0.241***	0.215***
	(0.0470)	(0.0458)	(0.0478)	(0.0543)	(0.0505)	(0.0531)
Performance	−1.562***	−1.343***	−0.425**	−1.548***	−1.367***	−0.883**
	(0.161)	(0.166)	(0.191)	(0.144)	(0.150)	(0.409)
Delaware*performance	1.162***	1.022***	0.836***	1.023***	0.945***	0.737***
	(0.277)	(0.238)	(0.231)	(0.277)	(0.232)	(0.224)
Log assets		0.0375***	0.0136		0.0365***	0.0224
		(0.0110)	(0.0124)		(0.0111)	(0.0147)
Book to market		0.185***	0.155**		0.177***	0.165**
		(0.0365)	(0.0770)		(0.0365)	(0.0753)
Volatility		2.275***	2.133***		2.162***	2.306***
		(0.265)	(0.262)		(0.286)	(0.276)
R&D		−0.135	−0.253		−0.132	−0.284
		(0.158)	(0.189)		(0.158)	(0.198)
Log Assets*performance			−0.159***			−0.108**
			(0.0254)			(0.0546)
Book to market*performance			−0.0470			−0.0141
			(0.188)			(0.192)
Volatility*performance			0.977			1.685*
			(0.696)			(0.886)
R&D*performance			−0.556			−0.591
			(0.375)			(0.420)
Post Sox		−0.0163	−0.00942		−0.00732	−0.00808
		(0.0356)	(0.0361)		(0.0359)	(0.0363)
Constant	−2.162***	−2.770***	−2.590***	−2.200***	−2.782***	−2.690***
	(0.0361)	(0.104)	(0.108)	(0.0397)	(0.106)	(0.122)
Observations	26,001	24,149	24,149	25,995	24,149	24,149
Pseudo R^2	0.0308	0.0546	0.0739	0.0468	0.067	0.0746
Average marginal effect of performance						
Delaware	−0.0276***	−0.0210***	−0.0036	−0.0321***	−0.0273***	−0.0093
Others	−0.0813***	−0.0710***	−0.0453**	−0.0764***	−0.0713***	−0.0460***

(*continued on next page*)

Table 8
(Continued)

Panel B1: propensity matched sample

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	CEO performance				Recent performance			
	Probit	Marginal effects	Probit	Marginal effects	Probit	Marginal effects	Probit	Marginal effects
Delaware	0.158***	0.0089***	0.122**	0.0066**	0.159***	0.0084***	0.125**	0.0064**
	(0.0497)	(0.0027)	(0.0506)	(0.0026)	(0.0497)	(0.0026)	(0.0506)	(0.0025)
Performance	−0.769**	−0.0433***	−0.576**	−0.0312**	−0.921***	−0.0483***	−0.752***	−0.0386***
	(0.316)	(0.0158)	(0.258)	(0.0132)	(0.307)	(0.0126)	(0.272)	(0.0120)
Log assets			0.0233*	0.0013*			0.0216	0.0011
			(0.0139)	(0.0008)			(0.0140)	(0.0007)
Book to market			0.195***	0.0106***			0.174***	0.0089***
			(0.0576)	(0.0033)			(0.0566)	(0.0031)
Volatility			2.474***	0.134***			2.288***	0.117***
			(0.430)	(0.0255)			(0.485)	(0.0292)
R&D			−0.358**	−0.0194**			−0.378**	−0.0194**
			(0.181)	(0.0098)			(0.181)	(0.0093)
Post Sox			−0.0628	−0.0034			−0.0529	−0.0027
			(0.0482)	(0.0026)			(0.0481)	(0.0025)
Constant	−2.081***		−2.583***		−2.119***		−2.571***	
	(0.0537)		(0.136)		(0.0615)		(0.136)	
Observations	28,370		26,524		28,365		26,524	
Pseudo R^2	0.0349		0.0553		0.0571		0.0748	

Panel B2: propensity matched sample – probit regressions with interaction terms

	(1)	(2)	(3)	(4)	(5)	(6)
	CEO performance			Recent performance		
Delaware	0.315***	0.259***	0.244***	0.353***	0.294***	0.266***
	(0.0654)	(0.0643)	(0.0644)	(0.0761)	(0.0727)	(0.0722)
Performance	−1.692***	−1.436***	−0.442*	−1.704***	−1.477***	−0.822*
	(0.278)	(0.259)	(0.267)	(0.253)	(0.239)	(0.482)
Delaware*performance	1.305***	1.101***	0.927***	1.189***	1.038***	0.839***
	(0.367)	(0.320)	(0.311)	(0.354)	(0.306)	(0.288)
Log assets		0.0242*	−0.00340		0.0230	0.00442
		(0.0139)	(0.0156)		(0.0141)	(0.0180)
Book to market		0.176***	0.145		0.166***	0.154*
		(0.0531)	(0.0883)		(0.0522)	(0.0866)
Volatility		2.318***	2.103***		2.134***	2.249***
		(0.389)	(0.380)		(0.388)	(0.395)
R&D		−0.389**	−0.614**		−0.379**	−0.643**
		(0.189)	(0.277)		(0.186)	(0.286)
Log assets*performance			−0.158***			−0.118*
			(0.0310)			(0.0615)
Book to market*performance			−0.0419			−0.00825
			(0.202)			(0.206)
Volatility*performance			0.600			1.226
			(0.836)			(1.103)
R&D*performance			−0.869			−0.903
			(0.577)			(0.627)
Post Sox		−0.0653	−0.0522		−0.0523	−0.0509
		(0.0481)	(0.0485)		(0.0479)	(0.0485)
Constant	−2.201***	−2.667***	−2.453***	−2.257***	−2.683***	−2.549***
	(0.0578)	(0.141)	(0.142)	(0.0662)	(0.146)	(0.160)
Observations	28,370	26,524	26,524	28,365	26,524	26,524
Pseudo R^2	0.0395	0.0636	0.0840	0.0586	0.0787	0.0840
Average marginal effect of performance						
Delaware	−0.0271***	−0.0224***	−0.0082	−0.0342***	−0.0292***	−0.0011
Others	−0.0854***	−0.0741***	−0.0498***	−0.0872***	−0.0747***	−0.0416***

In Panels A2 and B2, we include interaction terms of performance with Delaware (and other firm characteristics). We find that the coefficient for the interaction variable for Delaware*Performance is positive and significant, suggesting that while Delaware CEOs are more likely to be terminated, Delaware firms are less sensitive to performance in making that decision. Marginal effects are difficult to interpret since the marginal effect of changing Delaware and Performance is not equal to the marginal effect of changing just the interaction (Norton et al., 2004). So, we compute the average marginal effects of performance for Delaware and non-Delaware firms, and come to the same conclusion. For example, the average marginal effect of forced turnover to recent performance for Delaware firms for the Execucomp sample is −0.0321 (in model 4, Panel A2 of Table 7) while it is −0.0764 for non-Delaware firms. The interaction effect, which is the difference between the two, is positive. This suggests that Delaware firms fire managers prior to an onset of significant poor performance.

Delaware's corporate code, like that of other states, does not speak directly to the decision by the board to retain or fire top management. If state corporate law influences management tenure, it seems clear that the effect is indirect, i.e., if the protections Delaware affords directors against liability encourages lax monitor-

ing (or attracts better directors), this may be reflected in the governance of those firms. In the previous section we document evidence that Delaware firms have more institutional ownership, have directors who are paid more and who hold more directorships, even after controlling for firm characteristics that are thought to influence these governance measures. So, it is possible that the governance differences in Delaware that cannot be fully explained by differences in financial characteristics could be related to the higher turnover we observe in Delaware.

5.5. Robustness checks

We do a number of tests of the robustness of our conclusions. First, we substitute performance quintiles for the linear industry-adjusted performance measure used in the regressions reported in Table 8. The coefficients and their significance for these regressions are qualitatively similar. An earlier version of this paper used a sample extending from 1993 to 2004 and we found similar results, so our central findings are not time dependent. We rerun the regressions presented in Table 8 excluding financial institutions from the sample; financial institutions face a substantially different regulatory regime, which may affect turnover. The results for these regressions are qualitatively unchanged. Finally, all of our results qualitatively hold when we model all CEO turnover (Forced + Other). For example, when we run regressions similar to those in Table 8 with all CEO turnover as the dependent variable, the Delaware coefficient is significant at the 1% level in all the regressions, and the interacted variable, Delaware*Performance is positive and significant at the 5% level.

5. Conclusion

This study focuses on corporate governance in Delaware, the overwhelming winner in the competition for corporate charters. The race-to-the-bottom hypothesis suggests that Delaware encourages lax monitoring by protecting directors against liability. Our results do not support that hypothesis. We find that Delaware firms have governance characteristics that differ from firms incorporated elsewhere, but we do not find evidence of weak governance. Our findings suggest that boards of Delaware firms are more likely to terminate their CEOs than firms incorporated in other states, which does not seem like entrenchment. We also find, however, that those decisions are less sensitive to firm performance than in other states.

What do these results tell us about the competition among states for corporate charters? We have used propensity score matching in an effort to control for endogeneity in incorporation choice. We acknowledge, however, that the available methods are inadequate to allow strong inferences in this area. Financial characteristics and governance are necessarily endogenous in a regime that allows for issuer choice of incorporation. Moreover, measures of governance quality are inherently noisy because they cannot fully control for differences in firm characteristics and operating environment. We believe, nonetheless, that showing an association of Delaware incorporation to governance choices and outcomes sheds light on the debate over state incorporation. We conjecture that the reduced sensitivity of termination decisions to performance may reflect the relative opaqueness of firms incorporated in Delaware. Delaware firms have characteristics associated with growth firms: lower book to market ratio, greater expenditures on R&D, and greater stock price volatility. Those characteristics may make the decision to terminate a CEO more complicated than simply focusing on stock returns. Alternatively, our results are also consistent with Delaware directors turning over CEOs even prior to the onset of poor performance. When performance is classified into quintiles, we find that forced turnover is higher across all quintiles in Delaware, suggesting that turnover performance sensitivity may not be the only measure of strong monitoring. In any event, we caution that we do not examine how turnover affects subsequent firm performance, so we draw no conclusions about whether Delaware boards are making efficient termination decisions. Our mixed results—Delaware CEOs are more likely to be fired, but the decision is less sensitive stock price performance—may say as much about the limitations of those proxies for the quality of monitoring as they do about the relation of state corporate law to governance. All we can say based on these results is that Delaware boards are not reluctant to terminate CEOs, even if the reasons are not closely related to stock performance. Overall, the relationship between incorporation choice, financial characteristics, and the decision to terminate the CEO appears to be more nuanced than the race-to-the-bottom hypothesis would suggest.

Appendix 1. Variable definitions

Variables	Definitions
COMPUSTAT	
Total assets	In millions – (at).
Book to market	Ratio of the book value of equity to the market value of equity – (equity/csho*prcc_c).
R&D	Amount of research and development, scaled by sales – (xrd/sale).
Dividend yield	Cash Dividend divided by market capitalization – div/(prcc_c*csho).
CRSP	
Firm age	Number of years since first date of trading on CRSP.
Stock volatility	Standard deviation of monthly stock returns estimated over the last two years (Year −2 and Year −1) prior to the current fiscal year (Year 0).
Stock turnover	Average Monthly Turnover (Volume / Shares Outstanding).
Momentum	Raw return over the past 12 months.
CEO performance	Past five-year return or the return over the CEO's tenure, whichever is shorter. Adjusted for returns in the Fama-French industry during the period.
Recent performance	Return over the past two years – Year 0 and Year −1. During turnover years, only the return till the date of the turnover is used. Adjusted for returns in the Fama-French industry during the period.
IRRC/Execucomp	
Director retainer	Cash compensation paid to directors. Since this data is not available after 2005, we substitute Cash-fees scaled by a multiplier. The Multiplier is calculated as the average ratio of Cash-fees in 2006 to Director retainer in 2005.
Directorships	Mean number of outside directorships per outside director.
CEO tenure	Number of years since CEO took office.
CEO–chair	Dummy variable equals one if the CEO is also the chairman of the board; zero if the positions are separated.
CEO directorships	Number of outside directorships held by the CEO.
Board size	Number of members in the board of directors
Other	
Takeover activity	Total value of transactions reported on SDC in the prior year for a given Fama-French industry divided by the sum of assets for all firms with positive total assets on Compustat in that industry.
Class action	Federal securities class actions, as reported by Securities Class Action Clearinghouse.
Litigation risk	Predicted value from a logistic regression of class action lawsuits. The dependent variable is a dummy variable that equals '1' if a suit is filed in that year and '0' otherwise. Independent variables are log of total assets, book to market ratio, firm age (years since ipo), stock volatility, stock turnover, and post-SOX dummy.
Institutional ownership	Percentage of shares held by institutions; Spectrum data from Thompson Financial
Post-SOX	Indicator variable equal to one for observations after the enactment of Sarbanes Oxley Act (post 2001) and zero for earlier years.
Founder CEO	Current CEO is a founder of the company, as reported in company's proxy statement.
Forced turnover	Similar to methodology in Parrino (1997). Indicator variable equal to one if newspaper reports indicate that CEO was forced out, if the board mentions dissatisfaction with firm performance, if there are disagreements between the CEO and the board of directors, or if the departure is unexpected and no particular reason was provided for the departure; zero otherwise. Source: Factiva news searches

Appendix 2. Cited reasons for reincorporations in SEC filings (357 filings–86 firms reincorporating from DE and 271 incorporating into DE)

	Frequency of mentions		
	From DE	To DE	Example
Predictability	5	244	Prominence, predictability and flexibility of delaware law For many years Delaware has followed a policy of encouraging corporations to incorporate in that state, and in furtherance of that policy, has been a leader in adopting and implementing comprehensive, flexible corporate laws responsive to the legal and business needs of corporations organized under its laws. Both the Delaware legislature and courts have demonstrated an ability and a willingness to act quickly and effectively to meet changing business needs. The Delaware courts have developed considerable expertise in dealing with corporate issues, and a substantial body of case law has developed construing Delaware law and establishing public policies with respect to corporate legal affairs. As a result, many corporations have chosen Delaware initially as their state of incorporation or have subsequently changed corporate domicile to Delaware in a manner similar to the Reincorporation proposed by the Company. The Company believes that shareholders would benefit from the responsiveness of Delaware corporate law to their needs and to those of the corporation they own.
Attract directors	3	120	Increased Ability to Attract and Retain Qualified Directors Both California and Delaware law permit a corporation to include a provision in its charter which reduces or limits the monetary liability of directors for breaches of fiduciary duty in certain circumstances. The increasing frequency of claims and litigation directed against directors and officers has expanded the risks facing directors and officers of corporations in exercising their respective duties. The amount of time and money required to respond to such claims and to defend such litigation can be substantial. The Company desires to reduce these risks to its directors and officers and to limit situations in which monetary damages can be recovered against its directors so that it may continue to attract and retain qualified directors who otherwise might be unwilling to serve because of the risks involved. The Company believes that, in general, Delaware law provides greater protection to directors than California law and that Delaware law regarding a corporation's ability to limit director liability is more developed and provides more guidance than California law.

(*continued on next page*)

	Frequency of mentions		
	From DE	To DE	Example
Corporate governance	1	43	Well Established Principles of Corporate Governance There is substantial judicial precedent in the Delaware courts as to the legal principles applicable to measures that may be taken by a corporation and as to the conduct of the board of directors, such as the business judgment rule and other standards. This tends to assure a significant measure of certainty to legal aspects of the conduct of business and a sound basis for planning. Therefore, the Company believes that its shareholders will benefit from the well-established principles of corporate governance that Delaware law affords.
Takeover protection	8	112	Delaware, like many other states, permits a corporation to adopt a number of measures designed to reduce a corporation's vulnerability to unsolicited takeover attempts through amendment of the corporate charter or bylaws or otherwise. The Reincorporation was NOT proposed in order to prevent such a change in control, and the Board is not aware of any present attempt to acquire control of the Company, or to obtain representation on the Board. In the discharge of its fiduciary obligations to its shareholders, the Board has evaluated the Company's vulnerability to potential unsolicited bidders. In the course of such evaluation, the Board has considered or may consider in the future certain defensive strategies designed to enhance the Board's ability to negotiate with an unsolicited bidder. These strategies include, but are not limited to, the establishment of a classified board of directors, the elimination of the right to remove a director other than for cause, the elimination of shareholder action by written consent, and the authorization of preferred shares, the rights and preferences of which may be determined by the Board. The Certificate of Incorporation of Tier Delaware contains a provision authorizing Tier Delaware's board of directors to issue preferred stock with rights, privileges, and preferences determined by the board of directors, which may have anti-takeover implications. It is important to note that Tier California's Articles of Incorporation contain a similar provision. In addition, Section 203 of the Delaware General Corporation Law, from which Tier Delaware does not intend to opt out, restricts certain "business combinations" with "interested stockholders" for three years following the date that a person becomes an interested stockholder, unless: (i) the corporation's board of directors approves the business combination prior to the transaction; (ii) the interested stockholder owns at least 85% of the outstanding stock of the corporation at the time of the transaction; or (iii) at or subsequent to the transaction, the corporation's board of directors and at least 66 2/3% of the disinterested outstanding voting stock of the corporation approves the transaction.
Franchise fees savings	72	5	"The sole factor in the Board of Directors' recommendation to reincorporate in Washington was that the Company's franchise fees will be substantially less in Washington than in Delaware. The Company expects to save approximately $42,560 annually ($127,560 annually) "The Board of Directors is proposing to change Castle's state of incorporation to Maryland because Maryland corporations are not subject to annual franchise taxes like those imposed by the State of Delaware on corporation" "Nevada was chosen by the Board as the new proposed state of Incorporation due to Nevada's favorable corporate and income tax laws. Nevada has no corporate income or franchise taxes on corporate income."
Restructuring and credit related	3	21	"By becoming a Delaware corporation, we will be able to benefit from Delaware's comprehensive and well-developed corporate laws. We believe that Delaware law will offer clearer guidance with respect to legal issues that may arise as a result of the existence of separate classes of common stock." The reincorporation will also effect a change in the capital structure of the Company so that sufficient shares of stock can be reserved for certain corporate purposes. These purposes include (i) the reservation of shares of Series B common stock and Series C common for issuance to the Company's lenders (who will become creditors of Merger Sub at the effective time of the merger) upon the exercise by the lenders of the warrants that they currently hold entitling them to purchase shares of Series B common stock and Series C common stock; (ii) the reservation of shares of Series A common stock for issuance to the lenders upon the conversion of their shares of Series B common stock and Series C common stock into shares of Series A common stock; (iii) the reservation of shares of Series A common stock for issuance under the Company's restricted stock plan and stock option plan, each of which will be assumed by Merger Sub upon consummation of the merger; and (iv) the reservation of shares of Series A common stock for issuance pursuant to the shareholder rights plan of the Company, which will be assumed by Merger Sub upon consummation of the merger. The amended and restated articles of incorporation of Merger Sub also create "blank check" preferred stock, all of the shares of which will be reserved for issuance in connection with an exercise of the stock purchase rights under the rights plan. For a description of the capital structure of Merger Sub, see the section entitled "The Merger – Description of the Capital Stock of the Company and Merger Sub." "The certificate of incorporation of Pacific Ethanol, Inc. (Delaware) authorizes the issuance of up to 100,000,000 shares of common stock. Accordingly, as a result of the reincorporation, the amount of authorized common stock increases from 30,000,000 shares to 100,000,000. An increase in the amount of authorized but unissued shares of common stock is critical to Accessity in light of the need to obtain additional equity financing in order to fund the construction of one or more ethanol plants and for other general working capital purposes.
Move to headquartered state	9	0	In addition, all of the Company's business activities and assets are located in Colorado. While Delaware courts have a reputation for their expertise in business law, the Company's water rights are subject to laws unique to Colorado and the Colorado courts are better positioned to evaluate the decisions the Company makes with respect to its water rights and its water service activities." "In addition to the proposed cost savings, the Board believes that reincorporation from the State of Delaware to the State of Florida is consistent with our philosophy of maintaining a positive corporate presence in Florida. Our principal executive offices are located in Florida. The Board believes that the Florida Act will meet the Company's business needs, and that the Delaware Law does not offer corporate law advantages sufficient to warrant payment of the franchise tax burden that results from our being a Delaware corporation. The Florida Act is a modern, comprehensive and flexible statute based on the Revised Model Business Corporation Act. For the most part, it provides the flexibility in management of a corporation and in the conduct of various business transactions that is characteristic of the Delaware Law."

(*continued on next page*)

	Frequency of mentions		
	From DE	To DE	Example
Lawsuits	8	2	In addition, reincorporation in Nevada may help us attract and retain qualified management by reducing the risk of lawsuits being filed against the Company and its directors. We believe that for the reasons described below, in general, Nevada law provides greater protection to our directors and the Company than Delaware law. The increasing frequency of claims and litigation directed towards directors and officers has greatly expanded the risks facing directors and officers in general of public companies in exercising their duties. The amount of time and money required to respond to these claims and to defend this type of litigation can be substantial. Delaware law provides that every person becoming a director of a Delaware corporation consents to the personal jurisdiction of the Delaware courts in connection with any action concerning the corporation. Accordingly, a director can be personally sued in Delaware, even though the director has no other contacts with the state. Nevada law has no similar consent provisions and, accordingly, a plaintiff must show the minimum contacts generally required of the director in Nevada for a state to have jurisdiction over a non-resident director. Also, Nevada law allows a company and its officers and directors, if personally sued, to petition the court to order a plaintiff to post a bond to cover their costs of defense. This motion can be based upon lack of reasonable possibility that the complaint will benefit the Company or a lack of participation by the individual defendant in the conduct alleged.
Obtain financing	0	20	The differences between the corporate law of Delaware and Florida allow Delaware corporations greater latitude of corporate action. In the opinion of management, such latitude affords Delaware corporations more opportunities to raise capital. For example, a Delaware corporation has greater flexibility in declaring dividends, which can aid a corporation in marketing various classes or series of dividend paying securities. Under Delaware law, dividends may be paid out of surplus, or if there is no surplus, out of net profits from the corporation's previous fiscal year or the fiscal year in which the dividend is declared, or both, so long as there remains in the stated capital account an amount equal to the par value represented by all shares of the corporation's stock, if any, having a preference upon the distribution of assets. Under Florida law, dividends may be paid by the corporation unless after giving effect to the distribution, the corporation would not be able to pay its debts as they come due in the usual course of business, or the corporation's total assets would be less than the sum of its total liabilities, plus (unless the corporation's articles of incorporation permit otherwise) amounts payable in dissolution to holders of shares carrying a liquidation preference over the class of shares to which a dividend is declared. These and other differences between Florida's and Delaware's corporate laws are more fully explained below in the section entitled "Summary of Significant Differences between Delaware and Florida Corporate Laws." In management's opinion, underwriters and other members of the financial services industry may be more willing and better able to assist in capital raising programs for corporations having the greater flexibility reflected in the examples mentioned.
Other	13	27	"The primary rationale for possibly reincorporating in Nevada is that Delaware law is more restrictive than Nevada law with respect to when dividends may be paid, and given the breadth of the Company's drug pipeline (eight product candidates in six subsidiaries) the fair value of the Company's product pipeline may not be fully appreciated by the investment community. The Company would like to have the flexibility to enter into transactions in which one or more of the Company's subsidiaries may be spun out to stockholders in order to potentially realize greater value for stockholders. Delaware corporate law does not allow such spin outs unless a company has sufficient retained earnings, whereas Nevada corporate law would permit the Company to effect spin out transactions. The Company has no plans to complete a spin out at this time. However, if this proposal is passed, the Company may choose within the next 24 months to spin off one or more of these subsidiaries and drug candidates in an effort to increase shareholder value. Liberty is proposing the reincorporation proposal to approve the reincorporation of Liberty from Delaware to Virginia, by means of the merger of Liberty into Liberty Virginia. The reincorporation merger is the first step of the business combination and must be completed in order to effect the second step share exchange, insofar as the Delaware General Corporation Law does not contain a share exchange provision comparable to that contained in the Virginia Stock Corporation Act.

References

Bebchuk, L.A., Cohen, A., 2003. Firms' decisions where to incorporate. J. Law Econ. 46, 383–425.

Black, B., Cheffins, B., Klausner, M., 2006. Outside director liability. Stanford Law Rev. 58, 1055–1159.

Cary, W., 1974. Federalism corporate Law: reflections upon delaware. Yale Law J. 83, 663–705.

Celikyurt, U., Sevilir, M., Shivdasani, A., 2010. Going public to Acquire? The acquisition motive in IPOs. J. Financ. Econ. 96, 345–363.

Coles, J.L., Daniel, N.D., Naveen, L., 2008. Boards: does one size fit all? J. Financ. Econ. 87, 329–356.

Dah, M., Frye, M.B., Hurst, M., 2014. Board changes and CEO Turnover: the unanticipated effects of the sarbanes-oxley act. J. Banking Financ. 41, 97–108.

Daines, R., 2001. Does delaware law improve firm Value? J. Financ. Econ. 62, 525–558.

Daines, R., 2002. In: The Incorporation Choices of IPO Firms, 77. University Law Review, New York, pp. 1559–1611.

Fama, E., Jensen, M., 1983. Separation of ownership and control. J. Law Econ. 26, 301–325.

Ferris, S.P., Jagannathan, M., Pritchard, A.C., 2003. Too busy to mind the Business? Monitoring by directors with multiple board appointments. J. Financ. 58, 1087–1111.

Fich, E.M., Shivdasani, A., 2006. Are busy boards effective Monitors? J. Financ. 61, 689–724.

Fisch, J.E., 2001. The peculiar role of the delaware courts in the competition for corporate charters. Univ. Cincinnati Law Rev. 68, 1061–1100.

Gompers, P.A., Metrick, A., 2001. Institutional investors and equity prices. Q. J. Econ. 116, 229–259.

Goyal, V.K., Park, C.W., 2002. Board leadership structure and CEO turnover. J. Corp. Financ. 8, 49–66.

Hartzell, J.C., Ofek, E., Yermack, D., 2004. What's in it for Me? CEOs whose firms are acquired. Rev. Financ. Stud. 37–61.

Hermalin, B., Weisbach, M., 2003. Boards of directors as an endogenously determined institution: a survey of the economic literature. Econ. Policy Rev. 7–26 Federal Reserve Bank of New York, Issue April.

Heron, R.A., Lewellen, W.G., 1998. An empirical analysis of the reincorporation decision. J. Financ. Quant. Anal. 23, 549–568.

Huson, M.R., Parrino, R., Starks, L.T., 2001. Internal monitoring mechanisms and CEO turnover: A long term perspective. J. Financ. 56, 2265–2297.

Jenter, D., Lewellen, K., 2014. Performance-induced CEO Turnover. Stanford University Working Paper.

Jenter, D., Kanaan, F., 2015. CEO turnover and relative performance evaluation. J. Fin. 70, 2155–2183.

Johnson, M.F., Nelson, K.K., Pritchard, A.C., 2007. Do the merits matter More? The impact of the private securities litigation reform act. J. Law, Econ. Org. 23, 627–652.

Kahan, M., 2006. The demand for corporate Law: statutory flexibility, judicial quality, or takeover protection? J. Law, Econ. Org. 22, 340–365.

Klausner, M., 1995. Corporations, corporate law, and networks of contracts. Va. Law Rev. 81, 757–852.

Linck, JamesS., Netter, J.M., Yang, T., 2008. The determinants of board structure. J. Financ. Econ. 87, 308–328.

Mansi, S.A., Maxwell, W.F., Wald, J.K., 2009. Creditor protection laws and the cost of debt. J. Law Econ. 52, 701–726.

Moodie, G., 2004. Forty Years of Charter Competition: A Race To Protect Directors from Liability?. Harvard University Working Paper.

Netter, J., Poulsen, A., 1989. State corporation laws and Shareholders: the recent experience. Financ. Manage. 18, 29–40.
Norton, E.C., Wang, H, Ai, C, 2004. Computing interaction effects and standard errors in logit and probit models. Stata. J. 4, 154–167.
Parrino, R., 1997. CEO turnover and outside Succession: a cross-sectional analysis. J. Financ. Econ. 46, 165–197.
Romano, R., 1985. Law as a Product: some pieces of the incorporation puzzle. J. Law, Econ. Org. 1, 225–283.
Subramanian, G., 2002. In: The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching, 150. University of Pennsylvania Law Review, pp. 1795–1873.
Thompson, R., Thomas, R., 2004. The public and private face of derivative lawsuits. Vanderbilt Law Rev. 57, 1747–1793.