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Nevada Continues to Lead Delaware and All Other States and Jurisdictions in 2014 Securities and Exchange Commission Trading Suspensions

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Cataldo, Fuller and Miller (2015 and 2014) and Cataldo, Miller, Fuller and Halsey (2014) have produced contemporary evidence of the ongoing and disproportionate consumption of federal regulatory resources by the state of Nevada. Nevada is gaining market share or market proportion in the "market for corporate law," while free-loading with respect to the consumption of federal regulatory resources. The literature stream on this topic is characterized as *the Nevada Effect*, where it is, frequently, suggested that Nevada has won the "race to the bottom" and Delaware continues to maintain its leadership position in the "race to the top."

Barzuza (2012) and Barzuza and Smith (2014) have published quite a bit on this topic. Nevada has developed a niche market, providing extraordinary protections for corporate boards of directors and executives. When compared to Delaware and other states, Nevada corporate law is designed to provide lesser (or no) benefits or protections to shareholders.

In this extension, we examine the entire population of 2014 Securities and Exchange Commission (SEC) trading suspensions,[1] by state of incorporation. Nevada continues to lead all other states and jurisdictions on this dimension, while increasing market share or market proportion in the market for corporate law. Clearly, Nevada has discovered and continues to exploit a segment of the market interested in the extraordinary protections that Nevada corporate law provides to boards of directors and executives. Nevada retains one-hundred percent of the corporate filing fees and revenues, while paying only a fraction of the regulatory costs incurred by all U.S. citizens: investigatory and regulatory costs incurred for U.S. Department of Justice (DOJ), Internal Revenue Service (IRS), Federal Bureau of Investigation (FBI) and SEC investigations, sanctions, and prosecutions, and the investment losses sustained by U.S. citizens, as the state of Nevada facilitates the growth of related stock fraud schemes.[2]

The remainder of this paper is organized, as follows: First, we make reference to the published research by Barzuza and others, on Nevada's successful establishment of a niche market and market segmentation, in general. Second, we provide some descriptive measures on the growth rate that Nevada enjoys, when compared to the market share or market proportion leader, Delaware, in the "market for corporate law." Third, we use OLS regression to examine the categorical data we assembled from Compustat and publicly available data on 2014 SEC trading suspensions. This is an atypical application of this statistical technique, but it identifies Delaware and Nevada as influential outliers. Finally, we summarize our findings. All data used in this paper is provided and/or publicly available, and the SEC trading suspensions are detailed in the Appendix.

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[1] Available at http://www.sec.gov/litigation/suspensions/suspensionsarchive/susparch2014.shtml.
[2] For an example of a collaborative effort by these agencies, see https://www.fbi.gov/losangeles/press-releases/2013/fourteen-arrested-for-market-manipulation-schemes-that-caused-thousands-of-investors-to-lose-more-than-30-million.

I. Market Segmentation – Nevada Corporate Law

Barzuza (2012) characterizes Nevada corporate law, as follows:

> Nevada has embarked on a strategy of market segmentation with a differentiated product – a shockingly lax corporate law. Nevada law generally protects directors and officers from liability for breaches of the duties of loyalty, good faith, and care that are widely believed to be staples of U.S. corporate law (935).

When viewed from a marketing perspective, a business' decision to choose the state in which to form a public corporation is ultimately a buying decision. States appeal to these buyers by offering incorporation options. While many businesses will choose to incorporate in their home state, others will eagerly investigate options offered by other states. When viewed in a larger context, states are competing for customers within the national "market for corporate law" (Bebchuk & Hamdani, 2002).

The market for corporate law suggests product differentiation with respect to legal and financial requirements states impose as part of the process for creating a legal entity. This market is especially of interest to out-of-state customers. Customers may compare various state options when forming a corporation (Kobayashi & Ribstein, 2011).

The U.S. market for corporate law consists of multiple sub-markets or market segments (Christ, 2012). Market segmentation includes both intentional and unintentional product differentiation in competitors' (i.e., states') marketing strategies.

The most notable state to differentiate its product is Delaware, which, historically, has attracted those seeking to incorporate in this state for its lengthy history of corporate case law and precedent. In a recent two-year period, nearly 85% of companies that "went public" chose to incorporate in Delaware (Hoffman, 2015). However, a different segment of customers may be addressed by those seeking alternatives.

In 2001, Nevada 'staked a claim' in the U.S. market for corporate law, which, like Delaware, is designed to target a specific market segment (Barzuza, 2012). A review of Nevada's marketing strategy, as related to key product, price, promotion and distribution marketing decisions (Christ, 2012), suggests that Nevada chose to target a largely "untapped" or unexploited market.

In terms of product decisions, Nevada's most significant difference compared to Delaware, rests with greater liability and privacy protection for corporate directors and officers (Kobayashi & Ribstein, 2011), as well as corporate tax advantages. For the target market it is pursuing, Nevada has positioned the components of its product as offering unique advantages, which it believes furnishes customers with more value than options offered by other states.

Second, in support of a product that Nevada views as offering greater value, the state has further set itself apart by choosing a premium pricing strategy with the upper-end cost to incorporate in Nevada reaching a maximum of $35,000 (Barzuza, 2012). Nevada's rationale for charging a higher price is consistent with their efforts to position their product as a high-value option with customers willing to accept a higher fee given the services (i.e., protection) they receive.

Third, Nevada has widely promoted their service through online advertising proclaiming such advantages as the state being "Tax Free" and "Haven of Choice" (Barzuza and Smith, 2014).

Finally, distribution of incorporation services, in the form of providing customers access to forms and other materials, is presented conveniently through an online option (Form a Nevada Corporation or Qualify as a Foreign (Non-Nevada) Corporation, n.d.).

By introducing a so-called "lax-law" marketing strategy, Nevada has extended greater legal and financial protections (Donelson & Yust, 2014) that have substantially reduced the need for disclosure while placing notable limits on liability (Grow and Carr, 2011). The consequence of Nevada's marketing strategy has resulted in a very significant increase in Nevada market share or market proportion by both in-state and out-of-state corporate entities.

However, Nevada's position in the incorporation market has also raised concerns regarding the long-term viability of corporations formed in that state (Barzuza and Smith, 2013). Previous analysis suggests Nevada has an unequal share of the market for corporate trading suspensions (Cataldo, Fuller and Miller, 2015). In an effort to further evaluate Nevada's standing in this market, additional research was conducted.

II. Descriptive Statistics and Growth Rate Comparisons

All Securities and Exchange Commission trading suspensions for the 2014 calendar year (N=546) are available in the Appendix, where n= 196 (36%) of these occurred for Nevada corporations and n = 174 (32%) of these occurred for Delaware corporations.

Table I contains the market share or proportion of U.S. corporations incorporated in the state of Nevada (NV%US), the state of Delaware (DE%US), and Nevada and Delaware, combined (NVDE%US), for 1987 through 2014. Note that Nevada has enjoyed an increase from 2.9% to 9.7% over this period, for a 234% increase. Over the same period, Delaware has increased, as well, but only from 46.9% to 55.3%, for an increase of only 18%. Combined, Nevada and Delaware and Nevada have improved their positions from 49.8% to 65.0%, for a combined increase of 31%, from these 2 market share or market proportion leaders, over this 28 year period.[3]

Refer Table I and Figure I

The market share or proportion gains achieved by Nevada are dramatic. We illustrate, graphically, both for Delaware and Nevada corporations and using the data in Table I to produce Figure I, using 1987 market share or proportion levels as a base year, as follows:

$$\text{NVCompustat\%}_{\text{AllYears}} - 2.9\%_{\text{1987BaseYear}} = \text{NVDifference\%} \qquad [1a]$$
$$\text{DECompustat\%}_{\text{AllYears}} - 46.9\%_{\text{1987BaseYear}} = \text{DEDifference\%} \qquad [1b]$$

Note the rate of convergence.

[3] While not the topic of this paper, it is interesting to note that the "market for corporate law" appears to be maturing, perhaps from a less competitive to a more oligopolistic structure or framework, as the combined percentage of market share or proportion for these two leading states grows.

III. Exploratory Regression Equations Used As a Diagnostic Model or Tool

Table II contains data summarizing the market share or proportion of each U.S. state or jurisdiction from Compustat alongside comparable measures for 2014 Securities and Exchange Commission trading suspensions. We, first, use an OLS regression equation to produce and exploratory examination of the categorical data contained in Table II.

Refer Table II

The regression equation was run both with (N=51) and without (N=49) Delaware and Nevada, as follows:

$$\text{Compustat}_{\%i} = \alpha_0 + \beta_1\text{SECSuspensions}_{\%i} + \varepsilon_i \qquad [2]$$

The adjusted r-squared measure was 56.4%[4] (N=51), and the single independent variable generated a t-statistic of 8.2 with a p-value at < 0.0001. The overall F-statistic was 67.0 with a p-value at < 0.0001. While it is not our intent to apply regression to categorical data to develop a predictive model, it is important to note that we used this powerful statistical technique to identify the fact that the observations for Delaware and Nevada were both influential (e.g., high leverage observations) and had large standardized residuals (e.g., 6.95 and -6.47, respectively). These were the only 2 influential observations sets or data pairs.

Furthermore, when both Delaware and Nevada observations were removed from the model (N=49), observation sets for both Florida and Colorado were influential (e.g., high leverage observations). Again, these were the only 2 influential observation sets or data pairs.

Finally, we can present this data in a more descriptive or graphic form, without the use of statistics, where the results are visually consistent with quantitative results.

Refer Figure II

Figure II graphically depicts, precisely, what the above regression equation results suggested. This bar chart of the frequency of Securities and Exchange Commission trading suspensions for 2014 ranks the leaders in SEC trading suspensions as Nevada, Delaware, Florida and Colorado, and in that order. While future investigations of the latter two states might be interesting, we confine the focus of the remainder of this paper on Nevada and Delaware. This focus is consistent with research on the "market for corporate law," and, as published in the literature.

IV. Limitations and Summary

There are no limitations with respect to the scope of the descriptive measures and results produced in this paper. We examined one-hundred percent of the population of 2014 SEC trading suspensions.

Nevada corporations, now, represent 9.7% of the Compustat population (see Table I). This increase, from 2.9% in 1987 and 8.5% is 2013 is remarkable, as Figure I suggests.

[4] The Pearson product moment correlation was 75.7% with a p-value < 0.0001.

Table II and Figure II provides for 2014 results that are consistent with examinations of prior years (Cataldo, Fuller and Miller 2014 and 2015, and Cataldo, Miller, Fuller and Halsey 2014). Delaware has 55.3% of the market for corporate law for 2014, but is under-represented, in terms of SEC trading suspensions, at 31.9%. Nevada has 9.7% of the market for corporate law for 2014, but is over-represented, in terms of SEC trading suspensions, at 35.9%. Nevada continues to succeed, as they exploit their differentiated product in the market for corporate law.

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Table I Market Share or Proportion of U.S. Corporations for Nevada (NV%US), Delaware (DE%US), and Combined (NVDE%US) 1987 through 2014

Year	NV%US	DE%US	NVDE%US
1987	2.9%	46.9%	49.8%
1988	3.0%	47.7%	50.7%
1989	3.1%	48.7%	51.8%
1990	3.0%	49.8%	52.8%
1991	3.0%	50.7%	53.7%
1992	3.1%	51.8%	54.9%
1993	3.1%	50.4%	53.5%
1994	3.0%	51.2%	54.2%
1995	3.0%	52.8%	55.8%
1996	3.0%	53.6%	56.6%
1997	3.0%	54.2%	57.2%
1998	3.1%	55.8%	58.9%
1999	4.6%	54.5%	59.1%
2000	5.5%	54.2%	59.7%
2001	6.0%	53.9%	59.9%
2002	5.9%	54.4%	60.3%
2003	6.2%	54.5%	60.7%
2004	6.2%	54.8%	61.0%
2005	6.1%	55.5%	61.6%
2006	6.3%	55.6%	61.9%
2007	7.0%	55.8%	62.8%
2008	7.0%	56.0%	63.0%
2009	7.4%	55.6%	63.0%
2010	8.1%	55.0%	63.1%
2011	8.3%	54.3%	62.6%
2012	7.3%	54.9%	62.2%
2013	8.5%	55.5%	64.0%
2014	9.7%	55.3%	65.0%

Table II Market Share or Proportion of Each U.S. State or Jurisdiction from Compustat Compared to the Percent or Proportion of U.S. State or Jurisdiction Corporations with Securities and Exchange Commission Trading Suspensions 2014

State	Compustat	Percent	SEC Suspensions	Percent
AK	3	0.05%	0	0.00%
AL	3	0.05%	0	0.00%
AR	8	0.14%	0	0.00%
AZ	8	0.14%	1	0.18%
CA	109	1.97%	14	2.56%
CO	53	0.96%	21	3.85%
CT	19	0.34%	0	0.00%
DC	6	0.11%	0	0.00%
DE	3,055	55.28%	174	31.87%
FL	114	2.06%	41	7.51%
GA	43	0.78%	6	1.10%
HI	6	0.11%	0	0.00%
IA	19	0.34%	0	0.00%
ID	5	0.09%	2	0.37%
IL	21	0.38%	2	0.37%
IN	59	1.07%	1	0.18%
KS	7	0.13%	0	0.00%
KY	18	0.33%	1	0.18%
LA	18	0.33%	1	0.18%
MA	51	0.92%	3	0.55%
MD	335	6.06%	3	0.55%
ME	7	0.13%	0	0.00%
MI	46	0.83%	2	0.37%
MN	75	1.36%	2	0.37%
MO	34	0.62%	1	0.18%
MS	10	0.18%	0	0.00%
MT	4	0.07%	0	0.00%
NC	43	0.78%	3	0.55%
ND	4	0.07%	0	0.00%
NE	5	0.09%	0	0.00%
NH	2	0.04%	0	0.00%
NJ	56	1.01%	3	0.55%
NM	4	0.07%	0	0.00%
NV	534	9.66%	196	35.90%
NY	111	2.01%	14	2.56%
OH	101	1.83%	3	0.55%
OK	19	0.34%	3	0.55%

OR	30	0.54%	1	0.18%
PA	113	2.04%	5	0.92%
RI	5	0.09%	0	0.00%
SC	16	0.29%	0	0.00%
SD	4	0.07%	0	0.00%
TN	23	0.42%	1	0.18%
TX	91	1.65%	11	2.01%
UT	24	0.43%	9	1.65%
VA	80	1.45%	1	0.18%
VT	2	0.04%	0	0.00%
WA	50	0.90%	4	0.73%
WI	52	0.94%	0	0.00%
WV	8	0.14%	0	0.00%
WY	7	0.13%	1	0.18%
Non-US	6	0.11%	16	2.93%
Total	5,526	100.00%	546	100.00%

Figure I Delaware (DE) and Nevada (NV) Market Share Trend – Percentage Increase Compustat – 1987 through 2014 – 1987 Base Year Developed from Table I

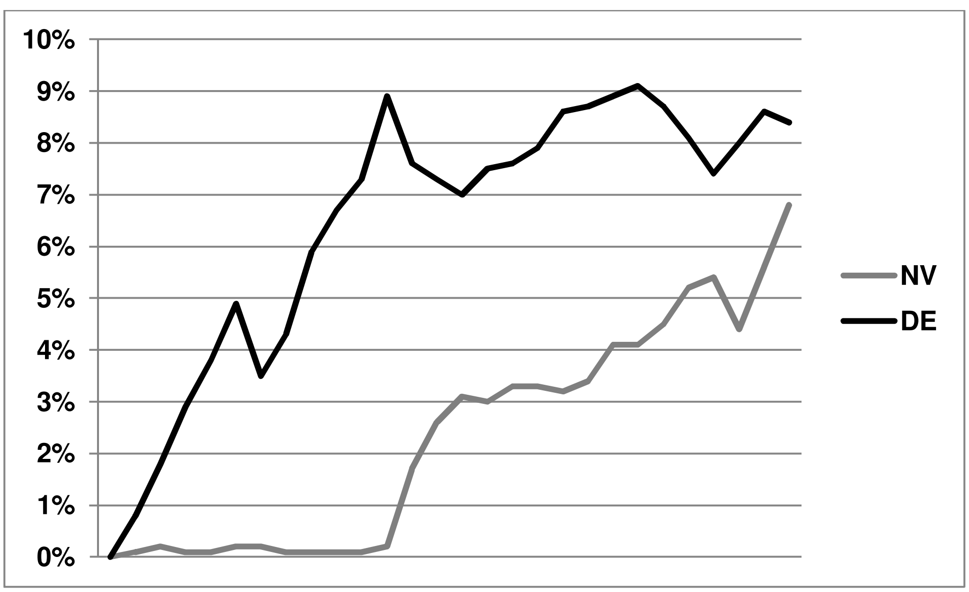

Figure II Securities and Exchange Commission Trading Suspensions – 2014 Graphic of State of Incorporation Frequency