

DELAWARE FOR SMALL FRY: JURISDICTIONAL COMPETITION FOR LIMITED LIABILITY COMPANIES†

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Most of the work on jurisdictional competition for business associations has focused on publicly held corporations and the factors underlying Delaware's dominance in attracting formations of large out-of-state corporations. We examine an analogous jurisdictional competition to attract formations by closely held limited liability companies (LLCs). The LLC offered the first attractive business form for closely held limited liability firms unconstrained by the legacy of corporate default rules. State legislatures have adopted and changed LLC statutes rapidly over the past twenty years. Unlike general and limited partnerships, which have been shaped by uniform laws, LLC statutes vary significantly. These circumstances offer an opportunity to test statutory provisions and other factors that influence LLCs' choice of where to organize. Exploiting a new database that for the first time reveals home and formation states of closely held firms, we find evidence that large LLCs, like large corporations, tend to form in Delaware, and that they do so for many of the same reasons—that is, for the quality of Delaware's legal system. We reject other potential explanations for LLCs' formation decisions based on variations in state statutory provisions. Our evidence sheds new light on forces underlying the market for law.

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I. INTRODUCTION

Much of the work on jurisdictional competition for business associations has dealt with publicly held corporations. In general, scholars have found that there are essentially two competitions: a national competition between Delaware and other states to attract firms that organize outside their home states and fifty-one local competitions between each state and Delaware to attract formation of firms based in each state. Delaware attracts a little more than half of all publicly traded corporations,¹ with most of the rest incorporating in their home states.

There has, however, been relatively little written on jurisdictional competition to attract formations of closely held firms. Indeed, interstate competition for these formations historically has been limited. Commentary on this issue has focused on the cost of jurisdictional choice.² States typically charge initial and annual fees both for being the state of organization and for qualifying firms organized elsewhere to do business locally.³ Because this cost of foreign incorporation of large firms is trivial compared to the size of the firm, incorporating outside the home state is a viable alternative to submitting to home state law. By contrast, the costs of organizing small firms outside their home state often outweigh the benefits. Tax law also has constrained competition for formations of closely held firms. Firms were potentially subject to the corporate tax if they had “corporate” features, the most important of which was limited liability.⁴ Thus, there was little reason for closely held firms to demand alternative forms or for states to supply them.

Recently circumstances have combined for the first time both to create a market for business forms suited to closely held firms and provide the opportunity to test this market. Tax law changes effectively removed restrictions on limited liability business forms for closely held firms. The critical events were the Internal Revenue Service decisions in 1988 to permit limited liability companies (LLCs) to be classified as partnerships for tax purposes⁵ and in 1996 to permit most closely held firms to choose whether to be taxed as corporations or partnerships simply by checking a box on their tax forms, irrespective of how they were organized.⁶

The LLC has been the most successful of the new business forms that arose from tax liberalization. In the wake of the tax changes, the

1. See Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CALIF. L. REV. 1775, 1810 (2002) (finding Delaware’s share to be 58% of publicly traded nonfinancial firms).

2. See *infra* note 23–25 and accompanying text.

3. See generally LARRY E. RIBSTEIN & ROBERT KEATINGE, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES § 4:17 (2004).

4. See LARRY E. RIBSTEIN, THE RISE OF THE UNINCORPORATION 99–101 (2010) (discussing the circumstances channeling closely held firms into the corporate form).

5. Rev. Rul. 88-76, 1988-2 C.B. 360–61.

6. Treas. Reg. § 301.7701-1–3 (2010). Most publicly traded partnerships, however, are taxed as corporations. See 26 U.S.C. § 7704 (2006).

number of states with LLC statutes increased from just four in 1992 to all fifty-one U.S. jurisdictions just a few years later.⁷ These statutes have undergone significant change over the last twenty years. There is evidence that LLC statutes have evolved toward efficient terms, as by eliminating undesirable mandatory rules,⁸ and that they have spontaneously moved toward efficient uniformity.⁹

This unusually rapid legal evolution offers an excellent opportunity to test jurisdictional choice, and specifically whether and how jurisdictional competition differs between publicly held and closely held firms. This evidence raises questions whether the evolution of LLC law has been spurred by competition and whether statutory variations affect LLCs' choice of where to organize.

In addition to these developments in the theory and law of closely held firms, there is now for the first time electronic data on closely held firms, including LLCs, that provides a basis for examining jurisdictional competition in this context. Specifically, this Article exploits data from the ICARUS database to empirically examine factors that influence LLCs' choice of formation state.¹⁰

Exploiting these developments, we find that large LLCs are more likely to organize outside their home state, and that Delaware is their dominant destination. We find little evidence that firms choose to form outside their home state in order to take advantage of variations in statutory provisions. Rather, our evidence suggests that most LLCs that form outside their home states choose Delaware. Thus, the jurisdictional competition for large privately held LLCs closely resembles that for large firms. In both contexts there are essentially two competitions—between Delaware and all other states for out-of-state formations, which Delaware has won by a wide margin, and a closer race between each state and Delaware for formations of locally-based firms. Moreover, LLCs seem to be attracted to Delaware for the same reason that public corporations are—that is, the quality of Delaware's legal system.¹¹ Thus, state variations in LLC statutes other than Delaware appear to be aimed at retaining local LLCs rather than attracting formations of firms based else-

7. See RIBSTEIN & KEATINGE, *supra* note 3, § 1:2 nn.16–76 (detailing history of LLC statutory adoptions).

8. See Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs*, 73 WASH. U. L.Q. 369, 412–28 (1995).

9. For discussions of uniform lawmaking and LLCs, see generally Bruce H. Kobayashi & Larry E. Ribstein, *Evolution and Spontaneous Uniformity: Evidence from the Evolution of the Limited Liability Company*, 34 ECON. INQUIRY 464 (1996), reprinted in UNCERTAINTY AND ECONOMIC EVOLUTION: ESSAYS IN HONOR OF ARMEN A. ALCHIAN 40–62 (John R. Lott, Jr. ed., 1997) [hereinafter Kobayashi & Ribstein, *Evolution and Uniformity*]; Bruce H. Kobayashi & Larry E. Ribstein, *The Non-Uniformity of Uniform Laws*, 35 J. CORP. L. 327 (2009) [hereinafter Kobayashi & Ribstein, *Non-Uniformity*]; Larry E. Ribstein & Bruce H. Kobayashi, *Uniform Laws, Model Laws and Limited Liability Companies*, 66 U. COLO. L. REV. 947 (1995).

10. The ICARUS data is described in more detail *infra* Part IV.A.

11. See *infra* note 20 and accompanying text.

where. Neither the shape of the market nor the nature of the competition differs in any obvious ways between the two contexts.¹²

The Article is organized as follows. Part II discusses general considerations underlying jurisdictional competition for closely held firms. Part III discusses our hypotheses regarding the specific factors that drive LLCs' jurisdictional choice. Part IV describes the data and discusses our regression results. Part V concludes.

II. JURISDICTIONAL COMPETITION FOR CLOSELY HELD FIRMS

This Part discusses the existing literature on state competition for business association law to provide a context for our analysis of the competition for closely held firms. This literature began by discussing whether state competition for revenue from incorporations of publicly held firms would lead to a race to the bottom,¹³ favoring inefficient, pro-management rules, or to the top, favoring efficient rules.¹⁴ Early data favored the latter hypothesis, as event studies showed significant and positive abnormal returns to firms' decisions to reincorporate in Delaware.¹⁵ Both models assumed that the demand for state chartering business would cause state statutes to evolve toward terms that successfully attracted incorporation business. This suggested that statutes might become uniform because states losing business to innovating states would imitate the latter's statutes in order to prevent further losses.¹⁶ This outcome would give firms little reason to incorporate out of state. An alter-

12. If anything, the competition for formations of closely held firms may be even more intense than that for publicly held firms. This observation is based on the significant evidence of evolution of LLC statutes discussed below, as well as on the effort expended on LLC statutes. See, e.g., Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, but Heading Where?*, 45 SYRACUSE L. REV. 1193, 1220–62 (1995) (showing significant work of state bar associations in creating and promoting new unincorporated business forms). The point of this article, however, is to portray the configurations of the law markets in the two contexts rather than to measure the intensity of competition. With respect to lawyers' incentives to participate in state law reform, see Larry E. Ribstein, *Lawyers as Lawmakers: A Theory of Lawyer Licensing*, 69 MO. L. REV. 299, 330–37 (2004).

13. For prominent commentary supporting the race to the bottom hypothesis, see Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1458–92 (1992); Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1177–99 (1999); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).

14. For prominent commentary supporting the race to the top hypothesis, see ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 14–24 (1993); Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 276–84 (1967); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and The Theory of the Corporation*, 6 J. LEGAL STUD. 251, 254–62 (1977).

15. See ROMANO, *supra* note 14, at 20; Robert Daines, *Does Delaware Law Improve Firm Value?* 62 J. FIN. ECON. 525, 529–49 (2001); Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 263–66 (1980). For a critique of this evidence, see Bebchuk et al., *supra* note 1.

16. See Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 229 (1985) (noting the literature's emphasis on "survivorship" and that as "a corollary of the process's efficient (optimal) outcome, uniform statutes are predicted").

native model is one of product differentiation, where states would seek to tailor their corporation statutes to attract certain types of firms.¹⁷ There is little evidence, however, of such product differentiation.¹⁸

The actual pattern of incorporations did not follow either of the paths predicted by these models. Rather, Delaware acquired and maintained a dominant share of out-of-state incorporations.¹⁹ The leading explanation for Delaware's dominance is its superior legal infrastructure, including its courts and well-developed corporate bar, which gives Delaware a strong competitive advantage that other states cannot easily replicate.²⁰

The pattern of incorporations raises the question of why some large firms incorporate outside of Delaware. As noted at the beginning of this Article, although Delaware has no effective competition for firms forming outside their home states, there is a vigorous competition between Delaware and firms' home states. Bebchuk and Cohen found evidence of a managerial agency cost theory of competition—that firms' incorporation choices were significantly influenced by antitakeover provisions in their home states.²¹ There is also some evidence that the formation choices of firms doing initial public offerings are influenced by whether they are advised by a national law firm or local lawyers.²²

As already noted, there has been relatively little discussion of whether jurisdictions compete to attract formations by closely held and unincorporated firms as they do for publicly held firms. The following sections discuss in more detail potential differences between the two contexts and some considerations that bear on the supply and demand sides of the state competition for closely held firms.

17. See RICHARD A. POSNER & KENNETH E. SCOTT, *ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION* 111 (1980); see also Barry D. Baysinger & Henry N. Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J.L. & ECON. 179, 184–90 (1985) (suggesting a self selection mechanism resulting in state specialization).

18. See, e.g., ROMANO, *supra* note 14, at 45–48.

19. See Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 388–94 (2003).

20. See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 576–82 (2002); Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 585–91 (1990); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1081–96 (2000); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 739–43 (2002); Romano, *supra* note 16, at 233–42. Delaware's advantage has been attributed to “network” effects that are inherently difficult to replicate. See Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 162–63 (1999); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 841–51 (1995).

21. See Bebchuk & Cohen, *supra* note 19, at 411–15. But see Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?*, 22 J.L. ECON. & ORG. 340, 357, 363–64 (2006) (showing evidence that firms seek flexible rules and high-quality judicial systems rather than takeover protection).

22. See Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1584–86 (2002).

A. *The Role of Firm Size*

Firm size is likely to be an important factor in jurisdictional competition for business association formations.²³ States typically charge initial and annual fees both for being the state of organization and for qualifying firms organized elsewhere to do business locally.²⁴ While these costs are likely to be trivial for large corporations,²⁵ they could be significant for small firms per dollar of capitalization. Small firms might avoid a qualifying fee if they do business in a single state and probably do not get much benefit out of shopping for law because they are involved in less litigation than larger firms.

Cost considerations suggest that jurisdictions might compete for relatively large closely held firms or for firms that conduct business in more than one state. The larger the firm, the smaller the per-capitalization cost of organizing outside the home state. States other than Delaware do not charge organization fees that scale significantly to size,²⁶ and no states scale fees for qualifying foreign closely held firms.²⁷ Moreover, the benefits of choosing the law may increase with size because larger firms are likely to have more litigation.

Although there is reason to expect state competition to apply mainly to larger firms, there are also reasons why states could compete even for the smallest firms. These firms may choose to locate their entire business in states with attractive laws rather than just choosing the state's governance law while remaining based in another state.²⁸ Small firms might be attracted not only by standard form rules suited to their needs, but also by laws that would minimize owners' liability to third parties. States have an incentive to attract business activity whether it is carried on by large or small firms.

B. *Closely Held Firms' Demand for Substantive Terms*

Assuming that some closely held firms may choose to organize outside their home state, there is a remaining question concerning the factors that drive this choice. One possible hypothesis is that firms organize in states that have the best substantive rules. In order to weigh this hypothesis against the competing infrastructure and uniformity hypotheses

23. See Ian Ayres, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U. L.Q. 365, 372–78 (1992); Roberta Romano, *State Competition for Close Corporation Charters: A Commentary*, 70 WASH. U. L.Q. 409, 412–14 (1992).

24. See generally RIBSTEIN & KEATINGE, *supra* note 3, § 4:17.

25. Bebchuk & Cohen, *supra* note 19, at 398.

26. See Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1220–21 (2001).

27. See Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. (forthcoming 2011).

28. For example, Florida has the second highest number of LLC formations, trailing only Delaware. Unlike Delaware, however, a high percentage of these formations are by firms that also locate in the state. See *infra* Table 2.

discussed below, it is helpful to understand why, in theory, substantive statutory rules might matter.

Although firms obviously have an incentive to shop for business association law in order to avoid unwanted mandatory rules, it is less clear whether a statute's non-mandatory default rules matter, since firms can achieve the same results simply by contracting for the rules they want. One possible answer is that the right mix of statutory default rules can reduce litigation, information, and other transaction costs by providing a well-defined and coherent set of terms. Well-defined terms increase the predictability of court rulings interpreting these terms and reduce third parties' information costs of contracting with the firm. A coherent set of terms can help courts determine how best to apply tax and regulatory statutes to particular types of firms and to interpret firms' contracts, and help firms to efficiently match statutory terms to their needs.²⁹

While both large and small firms benefit from coherent terms, the two types of firms may differ in how much they benefit from statutory variation. Large, publicly traded firms may benefit from significant standardization across the states to minimize investors' information costs, and therefore their cost of capital. Also, these firms rely on legislatures to revise their terms because of high shareholder collective action costs in making governance rules.³⁰ Although large firms may readily bear the costs of drafting initial terms when going public, the benefits of standardization, firms' difficulty of opting out of statutory provisions, and the application of federal and stock exchange rules all induce firms to demand substantial uniformity.

In contrast to large firms, closely held firms that are big enough to justify some customized drafting easily can adopt and change their contracts throughout their existence, do not need to offer their investors standardized terms, and are not subject to federal and stock exchange rules. It follows that these firms may have less need for particular statutory default and mandatory terms. States might be able to attract these larger firms mainly by offering statutes tailored to their needs. For example, states might offer coherent sets of rules designed for centrally managed firms and that accommodate contracting.

C. States' Incentives to Compete for Closely Held Firms

Even if some closely held firms choose to form outside their home states, they are likely to generate lower franchise fees than publicly held firms. This suggests that states are less likely to compete for closely held than for publicly held firms. On the other hand, if closely held firm statutes are less standardized than those for publicly held firms, any compe-

29. See generally RIBSTEIN, *supra* note 4, at 15–38 (discussing theoretical considerations driving choice of business association); Ribstein, *supra* note 8, at 373–84.

30. See Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 8–10 (2006).

tition in this context may matter more to the substance of the statutes than the competition for publicly held firms. Moreover, even if states are not motivated by substantial franchise fees to attract formations of closely held firms, they at least may have significant incentives to prevent firms domiciled in their state from choosing to form in states like Delaware. Thus, even if only a few firms organize outside their home states, this can be consistent with robust jurisdictional competition for formations of locally-based firms.

Any theory of state competition must explain what motivates state lawmakers to engage in the competition. Lawmakers may want to encourage firms to form under their state's statute in order to charge franchise fees and thereby reduce the tax burden on their constituents. Because closely held firms are unlikely to produce a big franchise fee payoff, however, the competition for these firms more likely has been driven by lawyers. Lawyers can earn fees by serving as local counsel for foreign firms and can attract potential clients to locate in the state by having efficient business association statutes. Lawyers may compete for market share within their states by using their participation in drafting business association statutes to develop their reputations.³¹ Lawyers also may simply enjoy the intellectual challenge and satisfaction of crafting statutes.

D. *The Role of Business Form*

There was little competition for formations of closely held corporations. Although some states enacted special close corporation provisions, only a small percentage of total corporations adopted these provisions.³² This was likely attributable to the fact that these provisions were mainly enabling, existed within general corporation statutes, and did not offer complete coherent sets of default rules. Thus, ill-fitting corporate default rules filled gaps in firms' customized agreements. The thin market for business forms also can be explained by tax constraints on limited liability closely held firms that existed until the late twentieth century.³³

31. See Ribstein, *supra* note 12, at 329–30.

32. See F. HODGE O'NEAL ET AL., O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCs: LAW AND PRACTICE § 1.20 (3d ed. 2010); Harwell Wells, *The Rise of the Close Corporation and the Making of Corporation Law*, 5 BERKELEY BUS. L.J. 263, 314 (2008). O'Neal et al. compiled data on close corporation filings in states with special close corporation provisions. The following are the 1992 ratios of special close corporation filings to total corporations: Alabama 5324/155,198; Wisconsin 5101/98,602; Pennsylvania 24,000/580,000; Kansas "a lot less" than 5% of total corporations; Missouri 863/82,694; Montana 828/97,009; Nevada 742/63,172; and Wyoming 753/12,422. O'NEAL ET AL., *supra* § 1.20. Delaware had no close corporation data in 1992 but reported 16,684 close corporations in 1985 and 202,115 total corporations in 1992. *Id.* § 1.20 & n.6. Texas reported that of all corporate filings, 3.71% were statutory close corporations in 1978 and 5.59% in 1979. *Id.* § 1.20. Two 1985 Texas studies based on different data showed 5.91% and 6.09% electing close corporation status. *Id.* Only California showed significant percentages of close corporations—28% in 1978 and 19% in 1985—but the attorney conducting the study thought those numbers "misleading" because most filings were by non-lawyers who did not understand the consequences of close corporation status. *Id.*

33. See *supra* text accompanying note 4.

There is, however, evidence consistent with state competition regarding LLC statutes. Unlike corporation statutes, LLC statutes were designed from the ground up for closely held firms. This helps explain why, after the IRS classified LLCs as partnerships for tax purposes in 1988,³⁴ all fifty states and the District of Columbia quickly adopted LLC statutes. There is evidence that these statutes have evolved toward efficient terms. While early LLC statutes contained undesirable mandatory rules and rules designed for centralized management, later statutes eliminated these features, replacing them with default partnership rules appropriate for firms using decentralized management.³⁵

LLCs and closely held corporations thus appear to be distinct phenomena from the standpoint of jurisdictional competition for business formations. The small number of firms forming under close corporation statutes indicates that these firms are not shopping for state laws and that states are doing little to design laws to compete for their business. Accordingly, we focus on the competition for LLCs rather than looking more broadly at all closely held firms.

E. Uniformity

We have seen that there is theoretically less need for statutory standardization for closely held than for publicly held firms. This difference, however, does not necessarily apply to all statutory provisions. Terms affecting third parties present the strongest case for uniformity because the smaller transaction amounts associated with infrequent third-party dealings are unlikely to motivate firms to engage in customized drafting or to search for different statutory terms. Firms, therefore, may economize on transaction costs by adopting uniform statutory provisions as to terms that mainly affect third parties. By contrast, provisions affecting the members involve frequent and repeated interaction where the net benefits from variation and innovation are likely to be high and the net benefits of uniform rules are likely to be the lowest.

There is evidence that LLC statutes have spontaneously evolved toward uniform provisions in situations where standardization is most likely to be efficient. Because the Uniform Limited Liability Company Act (ULLCA) was not promulgated until after the vast majority of states had passed their LLC statutes, uniform LLC statutes had little effect on the early evolution of LLC law.³⁶ LLC statutes nevertheless achieved significant uniformity as to third-party provisions for which uniformity is efficient under the above analysis.³⁷ This evidence is consistent with the existence of beneficial jurisdictional competition as to the level of uniformity, just as we have seen there is as to substantive statutory terms.

34. See *supra* text accompanying note 5.

35. See Ribstein, *supra* note 8, at 412.

36. See Ribstein & Kobayashi, *supra* note 9, at 951.

37. See Kobayashi & Ribstein, *Evolution and Uniformity*, *supra* note 9, at 477.

Uniform LLC acts, however, have undermined this efficient spontaneous uniformity. The promulgation of ULLCA decreased rather than increased both efficiency and uniformity by including many idiosyncratic provisions that have not been widely adopted by the states in their existing statutes.³⁸ The recently enacted Revised ULLCA continued this trend.³⁹

F. Legal Infrastructure

The courts, lawyers, and legislature of the enacting state play a role in state competition for business associations generally, closely held firms in particular. As discussed above,⁴⁰ commentators have theorized that this legal infrastructure is an important source of Delaware's strength in corporate law. Firms may choose to organize under a state's law not because of (and perhaps even despite) the specific terms of the statute but because the state's legal infrastructure can provide sophisticated advice; consistent, predictable, and sophisticated adjudication; and statutes that are current with business practices. Although the parties might be able to unbundle adjudication and lawmaking by contracting for a litigation forum other than the enacting state, the state of organization is likely to have the most experience interpreting its law.⁴¹ Indeed, courts in non-enacting states may decline to hear a case under another state's law in order to conserve judicial resources or to induce parties to organize and pay fees under the adjudicating state's law.⁴²

G. Implications

The above analysis has five main theoretical implications for the nature of competition for closely held firms. First, size matters. Larger firms are more likely than smaller firms to organize outside their home states, and therefore to be the object of any interstate competition. This consideration particularly applies to firms that organize outside their state of primary residence. States also may compete to attract smaller firms to change their state of location. Because states compete for business assets as well as business formations, they have an incentive to offer laws that will encourage even very small firms to locate as well as form in the state.

38. See Ribstein & Kobayashi, *supra* note 9, at 983 n.129.

39. See Kobayashi & Ribstein, *Non-Uniformity*, *supra* note 9, at 339–41.

40. See *supra* text accompanying note 20.

41. A state such as Delaware may have a specific expertise regarding organization law. Accordingly, parties may choose that state's law and courts for organization law issues but not for general contract interpretation. This may explain data showing that a substantial number of Delaware corporations chose New York law and New York as the litigation forum in a sample of merger agreements. See Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 2007 (2006).

42. See *infra* note 119 and accompanying text.

Second, because uniformity as to some types of statutory provisions may be efficient, and given evidence of spontaneous uniformity, any competition to attract formations by offering innovative or sophisticated substantive rules may be limited to the terms as to which uniformity is not efficient—that is, the terms that matter mainly in transactions among the members.

Third, states may compete for firms with their legal infrastructure rather than or in addition to the terms of their statutes. Firms may choose to organize in a state because they can count on the state's courts to provide high-quality, state-of-the-art adjudication and its legislature to continually update the law to reflect the latest business and legal developments. Firms may care little about what rules a particular statute provides at a particular time if they can count on the state's courts to sensibly interpret the statute and agreements and on the legislature to pay attention to ongoing developments. Indeed, firms may prefer that the legislature balance modernization against the need for legal stability and testing of new provisions.

Fourth, state competition for closely held firms is likely to focus on noncorporate statutes. Even if corporate statutes include terms designed for closely held firms, these terms are embedded within general default rules that are unsuited to closely held firms. Thus, it is appropriate to focus on the competition among LLC statutes.

Fifth, there are distinct national and local competitions. Even if states other than Delaware do not attract formations of out-of-state firms, they may still try to ensure that locally-based firms do not find it worthwhile to incur the costs of forming in Delaware or some other state. The data on out-of-state formations reveals the results of the national but not the local competition.

H. Prior Evidence

Variation in LLC statutes and the competing theories of competition for closely held firms raise the question whether the variation has significantly influenced LLCs' choice of where to organize. This question was addressed in a recent study of formation state choices by LLCs by Dammann and Schündeln,⁴³ who exploit electronic data on closely held firms contained in the ICARUS database to examine factors affecting LLCs' choice to exit or stay in the home state. Like Bebchuk and Cohen's analysis of corporations,⁴⁴ Dammann and Schündeln's depen-

43. Jens Dammann & Matthias Schündeln, *Where Are Limited Liability Companies Formed? An Empirical Analysis* (Univ. of Tex. Sch. of Law, Law and Economics Research Paper No. 126, 2008), available at <http://ssrn.com/abstract=1126257>.

44. Bebchuk & Cohen, *supra* note 19, at 411–15; see also Sattar A. Mansi & John K. Wald, *State Laws and Firm Payout Policy* 11 (May 14, 2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1404177> (using similar model to examine the effect that state restrictions on debt have on corporate payout policies).

dent variable is a dummy that equals one if the LLC forms in its home state.⁴⁵

Dammann and Schündeln find that larger LLCs (based on the number of employees and total revenues) are more likely to form outside their home state (4% total), particularly Delaware (42% of firms formed outside their home state).⁴⁶ They also find that firms tend to move away from states that offer less protection for minority investors, as indicated by the state's relatively low manager duty of care (gross negligence or waivable or both), or that allow companies to be dissolved by sub-unanimous vote, which can enable opportunism by dominant owners.⁴⁷ But the passage of ULLCA and court quality in the home state do not affect whether firms form in their home states. Dammann and Schündeln characterize their findings regarding exit from low-duty-of-care jurisdictions as showing a flight from laxity.⁴⁸ The Dammann and Schündeln study therefore indicates that variation in LLC statutes is critical in determining where LLCs form.

The Dammann and Schündeln analysis suggests a somewhat different competitive outcome for LLCs than for public corporations. The literature to date on public corporations indicates that both state legal infrastructure and variation in state laws may matter in determining incorporation choices. More specifically, the Bebchuk and Cohen study shows that public corporations may be influenced by pro-management takeover statutes to stay at home rather than incorporate in Delaware.⁴⁹ By contrast, Dammann and Schündeln support a flight *from* laxity.⁵⁰ The next Part presents data and analysis that, among other things, supports different conclusions from those reached by Dammann and Schündeln.

III. FACTORS IN THE COMPETITION FOR LLCs

The analysis so far in this paper suggests alternative hypotheses regarding state competition for LLCs. LLCs may choose states based on their legal infrastructure rather than the substance of their statutes. To the extent that LLCs choose states on the basis of the substance of their statutes, they may prefer stricter statutes, as Dammann and Schündeln's data suggest, or they may be looking for other characteristics. In order to adduce evidence on whether and how statutory variation is driving LLC competition, it is necessary to develop a theory of what variations are likely to affect firms' choices. This Part develops such a theory and applies this theory in identifying the statutory variations that are most likely to induce LLCs to form under particular laws. Based on this anal-

45. Dammann & Schündeln, *supra* note 43, at 17.

46. *Id.* at 8 tbl.1.

47. *Id.* at 19–20.

48. *Id.* at 19.

49. Bebchuk & Cohen, *supra* note 19, at 411–15.

50. *See* Dammann & Schündeln, *supra* note 43, at 19.

ysis, we design tests to determine the role of statutory provisions in LLCs' decisions where to organize.

A. *Quality of Legal Environment*

The literature on jurisdictional competition for public incorporations suggests that a significant theoretical factor in attracting firms is the quality of litigation outcomes in the state. The same factor may also be an important factor in attracting large LLCs. We use three alternative proxies for the quality of a state's legal environment: the 2007 Chamber of Commerce (COC) State Liability Systems Rankings Study;⁵¹ Choi, Gulati, and Posner's (CGP) rankings of state high courts' influence and productivity;⁵² and the cumulative number of LLC decisions in a state. Part IV, below, discusses the relative merits of these measures. We also examine the extent to which these measures are independent from a preference for formation in Delaware, whose legal infrastructure has been cited as an important factor in state competition for public corporations,⁵³ and which comes up first in the COC and CGP rankings. In order to determine if there is a quality of legal environment effect that is separate from a preference for Delaware, some of our regressions include dummy variables denoting whether an LLC chooses to locate or form in Delaware and some exclude Delaware firms.

B. *Mandatory vs. Flexible Rules*

The most obviously important factor in substantive law's role in jurisdictional competition is whether the rules are mandatory or can be varied by agreement. While firms may not care much about some mandatory rules, such as those concerning the firm's name, they may be very concerned about the ability to opt out of other rules, such as those concerning fiduciary duties. Firms may particularly care about a state's tendency toward mandatory or flexible rules. Accordingly, in testing for the role of flexibility, it may be appropriate to examine a group of rules as to which flexibility matters. To test the flexibility of LLC statutes, we use three specific factors in the regression analysis in which the statutes have shown significant variation:

- (1) Whether the statute allows the firm to waive fiduciary duties. This differs from the Dammann and Schündeln laxity variables, which relate solely to the ability to waive the duty of due care, and therefore theoretically should have little effect on firms'

51. See U.S. CHAMBER INST. FOR LEGAL REFORM, 2007 U.S. CHAMBER OF COMMERCE STATE LIABILITY SYSTEMS RANKING STUDY (2007), http://www.instituteforlegalreform.com/lawsuitclimate2007/pdf/Liability_System_Ranking_Study.pdf.

52. Stephen J. Choi et al., *Which States Have the Best (and Worst) High Courts?* (Univ. of Chi. Sch. Of Law, John M. Olin Law & Economics Working Paper No. 405, 2008), available at <http://ssrn.com/abstract=1130358>.

53. See *supra* text accompanying note 20.

choice of law decisions. By contrast, we test the effect of whether the statute enables firms to completely waive the fiduciary duties of care and loyalty.⁵⁴

- (2) Whether the statute enables firms to merge or otherwise combine with all types of firms, or instead restricts the types of permitted combinations. The additional flexibility of these statutes could be expected to matter especially to firms contemplating a transaction that is prohibited under the statute of either their own home state or that of the entity with which they are considering combining. This type of provision also may signal the relevant jurisdiction's general flexibility.
- (3) Whether the statute allows the firm to admit members who do not make a contribution or who otherwise lack an economic interest in the firm. Like inter-entity mergers, this could be a significant factor in ensuring the validity of particular types of contemplated transactions.

We test these variables both individually and bundled. We expect that bundling flexibility variables would have a greater effect, since firms are more likely to incur the expense of organizing outside their home state if the target jurisdiction is generally flexible than if it includes only a single element of flexibility. In bundling the variables we test the number of flexible provisions included in a state's LLC statute.

C. Innovation

Henry Hansmann argues that publicly held firms need legislatures to adjust the parties' contract over time as circumstances demand.⁵⁵ Firms particularly may need the relative certainty of statutes when new business practices come into use whose treatment by the courts is uncertain. One potentially significant type of innovative statutory provision concerns "series" LLCs. These statutes enable firms such as real estate companies to separate a single business into distinct entities with separate assets and liabilities.⁵⁶ If the firm tries to separate the assets and liabilities without using the series provision, a court might pierce the veil between the entities and attribute the liabilities associated with particular assets to the business as a whole. The series LLC may be considered a type of flexible provision because it facilitates a transaction that would be more difficult or costly in the absence of the provision. The series

54. The only remaining duty would be the implied contractual covenant of good faith and fair dealing, which exists in all contracts and cannot be waived. See Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 142-43 (comparing the implied good faith covenant and fiduciary duties).

55. See Hansmann, *supra* note 30, at 9.

56. See generally RIBSTEIN & KEATINGE, *supra* note 3, § 4:17 (discussing series LLCs).

LLC is also significant as a statutory innovation that enables a new type of business entity not available in states lacking a similar provision.

The salience of the series LLC innovation was indicated by the hotly debated decision of the National Conference of Commissioners on Uniform State Laws (NCCUSL) to omit such provisions from the recently promulgated Revised Uniform Limited Liability Company Act.⁵⁷ A state's adoption of a series provision not only provides flexibility for firms forming under the statute but also signals the legislature's general receptivity to innovation. As of the time of our test, only six states had adopted series provisions: Delaware, Illinois, Iowa, Oklahoma, Tennessee, and Utah.⁵⁸

Series provisions may or may not attract formations by out-of-state LLCs. Roberta Romano has observed that corporate statutory innovations diffuse among the states in an "S-curve" pattern.⁵⁹ This suggests that early adopting states may initially attract adoptions by out-of-state firms, but that this effect will diminish as the innovations diffuse among the states. On the other hand, the untested innovation may not attract adoptions by firms from states with reasonably efficient laws and legal infrastructures, particularly if the firms can count on their home states to eventually adopt the provision when it is broadly accepted.

D. Debtor Protection

Small firms may locate in states that offer their owners a high level of protection from creditors. LLC statutes may play some role in this through charging order provisions that limit creditors to receiving the distributions that otherwise would be paid to the members and bar them from exercising dissolution or other management rights that could disrupt the firm's operations.⁶⁰ Our asset-protection variable denotes statutes that make the charging order the exclusive remedy and provide that the creditor shall have no right to interfere with the management or force dissolution of an LLC.

Debtors might take advantage of charging creditors' lack of management or dissolution rights to use the statutes to establish virtual asset protection trusts that hold members' personal assets away from creditors' reach.⁶¹ Creditors may, however, pierce the veil of the asset protection LLC,⁶² challenge the use of a charging order to protect the assets of a sin-

57. See Larry E. Ribstein, *An Analysis of the Revised Uniform Limited Liability Company Act*, 3 VA. L. & BUS. REV. 35, 42–45 (2008) (discussing this decision).

58. See RIBSTEIN & KEATINGE, *supra* note 3, § 4:17 n.10 (discussing all states that have enacted series provisions, including Texas, which enacted its provision more recently than the study period).

59. See ROMANO, *supra* note 14, at 16.

60. See generally RIBSTEIN & KEATINGE, *supra* note 3, § 7:8 (discussing LLC charging orders).

61. See Larry E. Ribstein, *Reverse Limited Liability and the Design of Business Associations*, 30 DEL. J. CORP. L. 199, 204–05, 212–13 (2005).

62. See *Litchfield Asset Mgmt. Corp. v. Howell*, 799 A.2d 298, 310 (Conn. App. Ct. 2002).

gle-member LLC,⁶³ or challenge the conveyance to the LLC as fraudulent.⁶⁴ Debtors seeking protection therefore might want backup protection from creditors. Accordingly, we include as an additional variable whether the formation state limits the home exemption in bankruptcy. A large exemption may induce parties to locate their assets or small businesses in the state, and then to locally form LLCs that provide additional asset protection.

Statutory debtor protection also comes into play regarding piercing the LLC veil to reach members' individual assets. Veil-piercing is a common law doctrine applying general standards that obscure state-by-state differences. Dammann and Schündeln, however, test the effect of statutory provisions barring veil-piercing for mere failure to follow formalities. These provisions would be unlikely to affect firms' formation decisions, because even under common law rules courts are unlikely to pierce the LLC veil merely for failure to follow formalities.⁶⁵ Not surprisingly, as discussed below, neither we nor Dammann and Schündeln get statistically significant results for this variable.

E. The Degree of Uniformity

Our regression analysis measures the uniformity of each state LLC statute based on the number of states that have adopted each provision in the statute. For example, a state statutory provision that all other states have adopted has a uniformity measure of 51, while a provision no other state has adopted has a uniformity measure of 1. We then average the uniformity measures across all of the statute's provisions. We also provide separate uniformity measures for third-party, member provisions, and tax-related provisions. Our earlier work shows that uniformity has been achieved and is likely to be desirable for third-party and tax-related provisions, not for provisions that affect only the members and are not tax-related.⁶⁶

Dammann and Schündeln determine whether a state's adoption of ULLCA that NCCUSL promulgated in 1995 is a factor in firms' jurisdictional choice.⁶⁷ Use of this variable seems consistent with studies of public firms' choice of state of incorporation that used the adoption of the Model Business Corporation Act (MBCA) as a proxy for the effect of uniformity on choice of incorporation state,⁶⁸ and with Dammann and Schündeln's use of the same variable in their study of close corpora-

63. See *In re Albright*, 291 B.R. 538, 541 (Bankr. D. Colo. 2003).

64. See *Cendant Corp. v. Shelton*, 473 F. Supp. 2d 307, 311–12 (D. Conn. 2007).

65. See RIBSTEIN & KEATINGE, *supra* note 3, § 12.3.

66. See Kobayashi & Ribstein, *Evolution and Uniformity*, *supra* note 9, at 470–78; Kobayashi & Ribstein, *Non-Uniformity*, *supra* note 9, at 338.

67. See Dammann & Schündeln, *supra* note 43, at 21.

68. See Bebachuk & Cohen, *supra* note 19, at 402.

tions.⁶⁹ But there is strong reason to question the use of ULLCA to approximate the MBCA's effect in the corporate context. ULLCA was promulgated after most of the states had already passed LLC statutes,⁷⁰ and states achieved significant uniformity in the absence of a uniform law, especially as to third-party and tax-related provisions.⁷¹ Indeed, ULLCA and the Revised Uniform Limited Liability Company Act (RULLCA) often promoted *non-uniformity* by eschewing widely adopted leading forms in favor of rarely adopted idiosyncratic provisions.⁷² This non-uniformity effect likely was produced by the public choice characteristics of NCCUSL. By contrast, the MBCA is a model law produced under different conditions and constraints. Thus, in contrast to the MBCA, a state's passage of ULLCA is not a reliable indicator of uniformity and, if anything, indicates the opposite. Accordingly, it is not surprising that Dammann and Schündeln did not find this variable to be a significant predictor of firms' jurisdictional choice, and we do not expect it to be in our analysis. This lack of significance should not be taken as evidence against the importance of uniformity in LLC statutes, but rather as doing no more than confirming the non-uniformity of ULLCA.

F. *The Range of Competition*

The above discussion raises more general issues as to the role of substantive variations in state statutes in driving jurisdictional choice by LLCs. There are at least three reasons why LLCs may not choose their formation state based on the provisions of the statute at any given time. First, as discussed above regarding series LLCs, LLCs may not want untested provisions and may assume their home states will adopt the provisions when they have been tested.

Second, the demand for uniformity sharply constrains the level of state competition. Given this demand and the high level of spontaneous uniformity states have already achieved, states are unlikely to gain a competitive advantage by additional moves toward uniformity or by offering innovative or sophisticated substantive rules on matters where uniformity is efficient. Thus, competition over the substantive content of state statutes may be limited to terms as to which uniformity is not efficient—that is, the non-tax-related terms that matter mainly in transactions among the members.

Third, even innovations in member-related provisions may not be a significant factor in retaining in-state LLCs and attracting of out-of-state

69. Jens Dammann & Matthias Schündeln, *The Incorporation Choices of Privately Held Corporations* 21 (Univ. of Tex. Sch. of Law, Law and Economics Research Paper No. 119, 2008), available at <http://ssrn.com/abstract=1049581>.

70. Ribstein & Kobayashi, *supra* note 9, at 951.

71. Kobayashi & Ribstein, *Evolution and Uniformity*, *supra* note 9, at 470–78.

72. See Kobayashi & Ribstein, *Non-Uniformity*, *supra* note 9, at 350–51; Ribstein & Kobayashi, *supra* note 9, at 980.

LLC formations because members generally can provide for these variations in their operating agreement and because firms' marginal cost of including such customized terms in the operating agreement will be smaller than the marginal costs of out-of-state formation.

All of these considerations support a more significant role in jurisdictional competition of the overall quality of state legal environment, including courts, legislatures, and lawyers, than of the specific substantive rules states have adopted at any given time. As we will see, our data on LLC competition is consistent with this intuition.

G. *Dammann and Schündeln Variables*

As discussed in Part II.H, Dammann and Schündeln's main finding regarding LLCs' choice of formation states is that LLCs appear to be fleeing lax states, as indicated by the state's relatively low manager duty of care (gross negligence or waivable or both) or allowance of companies to be dissolved by sub-unanimous vote. We show below in Part IV that these results are based to some extent on questionable theory as well as errors in the coding and specification of variables. It is also not clear why these results should differ from the "flight to laxity" the authors found for close corporations based on the same database.⁷³ The fact that the study by Dammann and Schündeln is the only current study of LLC competition, however, warrants the inclusion of the authors' variables in our analysis.⁷⁴

There is no theoretical reason to believe that the Dammann and Schündeln laxity variables would significantly affect an LLC's decision where to form. To begin with, it is not clear why closely held firms would

73. Dammann & Schündeln, *supra* note 69, at 19–20 (finding that large closely held corporations tend to incorporate outside their home state if that state has low-quality courts, a high level of minority shareholder protection, or relatively high risk of veil-piercing).

74. As this paper was going to press, Dammann and Schündeln, *supra* note 43, posted a revised June 28, 2010 version of their article. Jens Dammann & Matthias Schündeln, *Where Are Limited Liability Companies Formed? An Empirical Analysis* (Univ. of Tex. Sch. of Law, Law and Economics Research Paper No. 126, 2010), available at <http://ssrn.com/abstract=1633472>. The authors' basic methodology and findings on court quality (no significant effect) and laxity (significant and negative effect) remain the same as in their original paper. See *id.* at 18–19. The primary change to the paper from the earlier draft is their analysis of a new variable that denotes whether or not a state has a statute that allows judicial dissolution of the LLC for oppression of minority owners. See *id.* at 10–11. Dammann and Schündeln find that LLCs flee states that have not enacted strong oppression statutes (i.e., the variable denoting absence of oppression statute in the home state is negative and significant). *Id.* at 17. This effect is theoretically questionable because the law in this area is still evolving, and the differences between various standards are not clear. See RIBSTEIN & KEATINGE, *supra* note 3, § 11:5 nn.21–23. Moreover, parties presumably could contract for stricter judicial dissolution standards even in weak-dissolution states and therefore would not have to flee to strong-dissolutions states. In any event, a closer look at the data does not support the Dammann and Schündeln result. The vast majority of the firms leaving non-oppression states (917 of 1085 firms, or 84.5%) are going to another non-oppression state, particularly Delaware, which makes it unlikely that firms are fleeing states because they lack an oppression remedy. See *infra* note 92. Not surprisingly, in light of the foregoing considerations, in regressions that include both a home and formation state oppression variable, neither variable was significant.

exit states that have default rules providing for low levels of minority protection. Firms would not demand high levels of minority protection unless they were looking for outside investors, which is unlikely for most of these very closely held firms. Even if the firms want minority protection, they can draft for the protection at lower cost than choosing to organize in a state that offers high-protection provisions as default or mandatory rules. Moreover, if the firms were seeking minority protection outside their principal place of business, it is not clear why they would tend to choose Delaware, as the data indicates they do. Delaware has two of the main low-protection provisions identified in the study—ability to opt out of the duty of care and ability to dissolve the firm by less than unanimous vote.⁷⁵

Even if their general theory worked, Dammann and Schündeln's independent variables are inconsistent with the theory for several reasons. First, the authors connect the duty of care to minority protection by arguing that “any norm that reduces the duty of care for managers has the potential to benefit controllers at the expense of minority investors.”⁷⁶ This does not follow because deviations from the standard of care would tend to reduce the value of the firm as a whole and thereby injure both majority and minority holders, rather than transfer value from the minority to the majority.

Second, even if the duty of care mattered to minority protection, the authors have not identified relevant differences regarding the default statutory duty. They distinguish between lax and strict standards by differentiating between statutes that require proof of gross negligence to show a breach of the duty and those that do not provide for this standard.⁷⁷ But these standards do not materially differ.⁷⁸ About a third of the statutes appear to require something like ordinary care—that is, acting as a “prudent person in similar circumstances,” but they qualify this standard by permitting the managers to rely on reports or the agreement.⁷⁹ A substantial minority of statutes do not specify the duty of care.⁸⁰ Although the “prudent person” standard sounds like negligence,

75. See DEL. CODE ANN. tit. 6, § 18-1101 (2005) (providing for broad enforcement of contracts); *id.* § 18-801(a)(3) (providing for dissolution “[u]nless otherwise provided for in a limited liability company agreement, upon the affirmative vote or written consent of the members of the limited liability company or, if there is more than 1 class or group of members, then by each class or group of members, in either case, by members who own more than two-thirds of the then-current percentage or other interest in the profits of the limited liability company owned by all of the members or by the members in each class or group, as appropriate”).

76. Dammann & Schündeln, *supra* note 43, at 14.

77. *Id.*

78. For analyses of the duty of care in LLC statutes, see RIBSTEIN & KEATINGE, *supra* note 3, app. 9–4 (tabulating duty of care standards); Elizabeth S. Miller & Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?*, 30 DEL. J. CORP. L. 343, 366–70 (2005).

79. See RIBSTEIN & KEATINGE, *supra* note 3, app. 9–4 (tabulating statutory duty of care provisions).

80. *Id.*

it leaves significant discretion to the courts, particularly in light of the reasonable-reliance qualification.

Third, apart from the specific statutory language, courts are likely to resolve ambiguities in the statutes by applying the more well-developed standards under partnership or corporate law. Partnership law traditionally applies something like a gross negligence standard,⁸¹ and this was the standard the Revised Uniform Partnership Act explicitly adopted.⁸² Corporate law generally applies the business judgment rule, which accords substantial deference to directors unless they have been disloyal or acted with gross negligence. ULLCA recognized the general rule by adopting the gross negligence standard.⁸³ RULLCA attempts to compromise between the ordinary care and gross negligence standards by providing for an ordinary care standard, but then qualifies this by making it subject to the business judgment rule.⁸⁴ A committee of lawyers reviewing RULLCA concluded that “the language as written appears circular, in that the prefatory language appears to restate what most believe to be the business judgment rule.”⁸⁵

Fourth, any differences in default standards of care are meaningless to the extent that the statute lets parties contract around the duty of care. In fact, the vast majority of statutes do explicitly permit the parties to contract around the duty of care, no statutes prohibit such contracts, and there is no case law support for prohibitions on such waivers.⁸⁶ Dammann and Schündeln take waiver into account both as an independent variable and as part of a joint variable combining the default duty of care and the ability to opt out.⁸⁷ But if the statute permits waiver of the duty of ordinary care, it is not clear why the default standard should affect a firm’s decision where to organize. In any event, there is little difference in effect between statutes that did, and did not, allow waiver of due care liability. Even if the statute does not explicitly allow waiver of due care liability, courts are very likely to apply something like the business judgment rule, given the inherent problem of judicial second-guessing of management decisions.⁸⁸ Conversely, if the statute allows the parties to waive due care liability, courts can still impose liability for breach of the

81. See ALAN R. BROMBERG & LARRY E. RIBSTEIN, *BROMBERG & RIBSTEIN ON PARTNERSHIP* § 6.07(f) (2010).

82. REVISED UNIF. P’SHIP ACT § 404(c) (1997) (providing that a partner’s duty of care is limited to refraining from engaging in “grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law”).

83. See UNIF. LTD. LIAB. CO. ACT § 409(c) (1996).

84. See REVISED UNIF. LTD. LIAB. CO. ACT § 409(c) (2006).

85. See James J. Wheaton, *Report of the RULLCA Task Force of the Partnerships and Unincorporated Business Organizations Committee of the Section of Business Law*, PUBOGRAM, (Am. Bar Ass’n Section of Bus. Law Comm. on P’ships and Unincorporated Bus. Org., Chicago, Ill.), July 2007, at 11. For a discussion of the compromise nature of the provision, see Ribstein, *supra* note 57, at 64–66.

86. See Ribstein, *supra* note 57, at 66.

87. See Dammann & Schündeln, *supra* note 43, at 14–15.

88. See RIBSTEIN & KEATINGE, *supra* note 3, § 9:2 n.3.

duty of loyalty, and therefore for its close cousin, the duty of good faith.⁸⁹ In any event, courts can hold that highly unreasonable conduct is at least circumstantial evidence of a loyalty breach. In short, there is little theoretical reason to believe that the Dammann and Schündeln care variables would have a significant effect on firms' decisions where to organize.

Fifth, with respect to the other law variable that is significant in Dammann and Schündeln's regression—the right to dissolve at will—the authors again provide no coherent theory as to why this should affect firms' decisions where to organize. They argue that a majority can use the power to dissolve opportunistically, so that the existence of a majority power to dissolve indicates lax minority protection.⁹⁰ But dissolution by dissociation can be viewed as a mechanism for protecting rather than oppressing minority members. This could change the theory of why the statute matters from a “flight to laxity” to a “flight from laxity.” As with the duty of care, it is not clear why controlling members would use this as a reason for forming under another state's law when, as under all statutes, the majority can simply draft for a power to dissolve. In any event, the authors have not identified the relevant variable. The question is not simply whether the majority can dissolve, but whether a single member can trigger dissolution by dissociating from the firm. This traditional partnership power of unilateral dissolution is certainly a form of sub-unanimous dissolution.

Finally, Dammann and Schündeln have a variable that indicates whether a state has adopted ULLCA, which is intended to measure the effect of uniformity in competing for LLCs.⁹¹ As discussed above in Part III.E, however, ULLCA has not been widely adopted, and many of its provisions are neither uniform nor widely adopted in other states. As a result, we do not expect the adoption of ULLCA to have a significant effect on out-of-state formation.

IV. DATA AND RESULTS

The previous Part provides guidance as to the types of statutory terms that might correlate with firms' decisions to organize outside the home state. We focus on the five factors listed in Part III—quality of law, flexibility, innovation, debtor protection, and uniformity—as well as the statutory factors contained in the Dammann and Schündeln analysis.

89. See *Stone v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006) (analyzing connection between corporate good faith and loyalty duties).

90. See Dammann & Schündeln, *supra* note 43, at 15, 19–20.

91. See *id.* at 16–17.

A. Description of Data

Our analysis of what causes LLCs to organize in particular states was based on the ICARUS database,⁹² also employed by Dammann and Schündeln, reflecting information on over fourteen million companies constructed from electronic records collected by Dun and Bradstreet.⁹³ Like Dammann and Schündeln, we collected data on firms whose listed names identify them as limited liability companies⁹⁴ and had reported data for employment and total revenue.⁹⁵ This search yielded 118,874 firms, of which 48,137 listed their state of formation.⁹⁶ We selected only company headquarters and single locations and did not include branch locations. We also limited our dataset to private firms. Using these criteria, our search yielded 805,414 LLCs that reported employment and revenue data, of which 282,383 listed their state of formation.⁹⁷

B. Formation State Data

Table 1 lists the data by state for all LLCs pulled from the ICARUS database and for LLCs with five or more and fifty or more employees. For comparison, we also list the number of active LLCs reported by the International Association of Commercial Administrators (IACA) in its 2007 annual report,⁹⁸ which includes both domestic and out-of-state (or

92. For an in-depth description of the ICARUS database, see Bureau van Dijk, *Icarus*, <http://www.bvdinfo.com/Products/Company-Information/National/ICARUS.aspx> (last visited Nov. 11, 2010).

93. For a description of the data collection procedures of Dun and Bradstreet (D&B), see Douglas P. Handler, *Business Demographics*, BUS. ECON., Apr. 1990, at 45, 46–47. A firm can request listing in D&B. A firm can also get listed if a third party requests credit information, or if a third party identifies a firm in its accounts receivable. D&B also searches public records to identify firms not otherwise identified.

94. We searched the company name field for firms that included the term “limited liability company,” “limited company,” or abbreviations of these terms.

95. Dammann and Schündeln used firms that reported data on employment for 2006. Dammann & Schündeln, *supra* note 43, at 6. Our dataset used all firms that reported employment and revenue numbers. In an attempt to adjust for this discrepancy, we also constructed a dataset of LLCs that reported data on employment and revenue for 2006 and had five or more employees in an attempt to replicate Dammann and Schündeln’s results.

96. Our dataset includes all firms whose name ended with the terms “limited liability company,” “limited company,” or abbreviations of these terms. Firms selected by our search that did not end with these terms were examined manually. Firms that were obviously not LLCs were coded with a 9 and not included in the regressions (e.g., “LLC Day Care, Inc.”). Duplicate listings were also coded and not included in the regressions.

97. We could not replicate the Dammann and Schündeln dataset, which found over 64,000 firms listing the state of formation using the same criteria. One reason for this discrepancy is the fact that our data is based on the August 2008 update of the ICARUS database (Update Number 57), whereas Dammann and Schündeln used data from the March 2008 update (Update Number 52). Dammann & Schündeln, *supra* note 43, at 6. ICARUS updates its database monthly, and between updates 52 and 57 added over 1.75 million companies and deleted 845,000 non-marketable or inactive companies. See Bureau van Dijk, *supra* note 92. Thus, our dataset is likely to have added new LLCs that did not report 2006 data and to have deleted LLCs that had data reported for 2006.

98. See THE INT’L ASS’N OF COMMERCIAL ADMIN., 2007 ANNUAL REPORT OF JURISDICTIONS (2007), available at <http://www.iaca.org/node/80>.

foreign) LLCs. The ICARUS data yields useful data on a small fraction of the number of LLCs listed in the IACA report.

Table 1
Data on LLCs by State

STATE	ALL COMPANIES				LLCs WITH 5 OR MORE EMPLOYEES				LLCs WITH 50 OR MORE EMPLOYEES							
	TOTAL FOR. DOM. LLCs (IACA)	LLCs LOCATED IN STATE (ICARUS)	LLCs REPORTING OUT OF STATE	% REPORTING OUT OF STATE	LLCs REPORTING OUT OF STATE (ICARUS)	LLCs REPORTING OUT OF STATE	% REPORTING OUT OF STATE	LLCs REPORTING OUT OF STATE (ICARUS)	LLCs REPORTING OUT OF STATE	% REPORTING OUT OF STATE	LLCs REPORTING OUT OF STATE (ICARUS)	LLCs REPORTING OUT OF STATE	% REPORTING OUT OF STATE			
AK	12,394	2,035	887	7	43.59%	0.79%	701	324	6	46.22%	1.85%	77	40	2	51.95%	5.00%
AL	13,044	5,092	74	39.04%	1.45%	3,471	1,688	37	48.63%	2.19%	342	159	12	46.49%	7.55%	
AR	36,761	5,889	1,781	39	30.24%	2.19%	1,458	545	24	37.38%	4.40%	181	69	11	38.12%	15.94%
AZ	259,628	25,253	15,491	156	61.34%	1.01%	6,736	4,240	78	62.95%	1.84%	695	427	20	61.44%	4.68%
CA	384,473	42,881	17,189	575	40.09%	3.35%	14,544	6,381	303	43.87%	4.75%	2,248	923	84	41.06%	9.10%
CO	175,006	31,183	538	126	1.73%	23.42%	6,214	284	66	4.25%	25.00%	618	64	25	10.36%	39.06%
CT	168,643	33,154	18,063	111	54.42%	0.61%	6,632	3,426	64	51.66%	1.87%	503	210	26	41.75%	12.38%
DC	3,437	3,437	909	145	26.45%	15.95%	1,041	301	76	28.91%	25.25%	120	32	12	26.67%	37.50%
DE	391,820	2,365	130	13	5.50%	10.00%	604	74	6	12.25%	8.11%	59	15	1	25.42%	6.67%
FL	379,175	54,692	23,312	329	42.62%	1.41%	11,439	5,420	165	47.38%	3.04%	1,413	599	46	42.39%	7.68%
GA	29,135	10,358	226	226	35.55%	2.18%	7,762	3,496	111	45.04%	3.18%	912	460	54	50.44%	11.74%
HI	31,998	4,022	1,941	9	48.26%	0.46%	973	499	4	51.28%	0.80%	116	57	3	49.14%	5.26%
IA	6,928	4,265	4,265	37	61.56%	0.87%	1,655	897	19	54.20%	2.12%	196	102	9	51.52%	8.82%
ID	41,584	6,603	3,208	34	48.58%	1.06%	1,411	661	11	46.85%	1.66%	123	53	1	43.09%	1.89%
IL	114,830	16,081	5,816	338	36.17%	5.81%	5,796	2,258	204	38.96%	9.03%	1,113	421	103	37.83%	24.47%
IN	109,957	14,430	5,697	93	39.48%	1.63%	3,783	1,550	52	40.97%	3.35%	572	242	20	42.31%	8.26%
KS	44,355	7,473	3,277	61	43.85%	1.86%	2,303	1,120	36	48.63%	3.21%	242	121	13	50.00%	10.74%
KY	68,174	13,210	6,419	85	48.59%	1.32%	3,331	1,738	57	52.18%	3.28%	436	232	22	53.21%	9.48%
LA	153,657	18,588	646	65	3.48%	10.06%	5,522	393	45	7.12%	11.45%	682	79	17	11.58%	21.52%
MA	83,916	10,008	4,890	170	48.86%	3.48%	3,095	1,474	103	47.63%	6.99%	507	211	43	41.62%	20.38%
MD	134,976	21,573	9,673	166	44.84%	1.92%	5,233	2,446	88	46.74%	3.60%	571	250	32	43.78%	12.80%
ME	20,361	2,200	632	21	28.73%	3.32%	712	270	7	37.92%	2.59%	98	43	2	43.88%	4.65%
MI	319,492	32,603	1,328	120	4.07%	9.04%	7,375	735	55	9.97%	7.48%	827	121	21	14.63%	17.36%
MN	69,951	11,469	3,397	66	29.62%	1.94%	2,821	1,030	40	36.51%	3.88%	424	154	22	36.32%	14.29%
MO	177,565	17,422	7,552	99	43.35%	1.31%	4,701	2,095	38	44.56%	1.81%	487	211	13	43.33%	6.16%
MS	61,085	6,672	3,210	38	48.11%	1.18%	1,910	983	28	51.47%	2.85%	194	113	11	58.25%	9.73%

Table 1 – Continued

MT	38,056	3,624	2,664	16	73.51%	0.60%	766	535	7	69.84%	1.31%	53	27	3	50.94%	11.11%
NC	128,660	25,940	13,664	173	52.64%	1.27%	6,004	3,210	89	53.46%	2.77%	784	382	38	48.72%	9.95%
ND	7,952	945	497	8	52.59%	1.61%	292	154	4	52.74%	2.60%	41	11	0	26.83%	0.00%
NE	28,957	3,880	1,749	34	45.05%	1.94%	964	390	16	40.46%	4.10%	125	57	4	45.60%	7.02%
NH	40,703	6,009	1,624	34	27.03%	2.09%	1,471	528	19	35.89%	3.60%	120	43	7	35.83%	16.28%
NJ	259,837	37,237	1,198	232	3.22%	19.37%	8,327	703	138	8.44%	19.63%	835	152	62	18.20%	40.79%
NM	5,073	2,964	2,964	20	58.43%	0.67%	1,304	740	5	56.75%	0.68%	125	52	1	41.60%	1.92%
NV	114,668	8,065	2,248	38	27.87%	1.69%	2,438	836	12	34.29%	1.44%	303	112	4	36.96%	3.57%
NY	323,282	39,500	1,978	441	5.01%	22.30%	11,766	1,179	245	10.02%	20.78%	1,799	310	104	17.23%	33.55%
OH	258,395	26,602	8,569	152	32.21%	1.77%	6,680	2,839	102	42.50%	3.59%	880	395	52	44.89%	13.16%
OK	99,782	9,558	3,666	38	38.25%	1.04%	2,730	1,098	22	40.22%	2.00%	342	144	9	42.11%	6.25%
OR	87,491	12,380	5,416	47	43.75%	0.87%	3,147	1,473	23	46.81%	1.56%	299	152	11	50.84%	7.24%
PA	137,668	16,620	7,785	168	46.84%	2.16%	4,716	2,257	96	47.86%	4.25%	722	300	52	41.55%	17.33%
RI	17,740	2,534	54	28	2.13%	51.85%	569	27	13	4.75%	48.15%	73	7	5	9.59%	71.43%
SC	15,774	6,977	91	91	44.23%	1.30%	3,611	1,585	48	43.89%	3.03%	400	166	21	41.50%	12.65%
SD	11,022	1,633	488	14	30.50%	2.81%	420	193	9	45.95%	4.66%	46	27	3	58.70%	11.11%
TN	54,751	16,459	7,371	129	44.78%	1.75%	5,824	3,075	62	52.80%	2.02%	682	360	14	51.32%	4.00%
TX	254,834	46,145	15,387	314	33.34%	2.04%	12,246	4,970	178	40.58%	3.58%	1,343	502	69	37.38%	13.75%
UT	95,677	14,322	7,070	66	49.36%	0.93%	3,199	1,538	27	48.08%	1.76%	287	140	11	48.78%	7.86%
VA	149,331	27,228	13,083	208	48.05%	1.59%	6,419	3,090	103	48.14%	3.33%	665	321	40	48.27%	12.46%
VT	11,343	1,466	563	6	37.72%	1.08%	360	106	3	29.44%	2.53%	33	6	1	18.18%	16.67%
WA	130,318	19,747	7,532	120	38.14%	1.59%	5,135	2,244	50	43.70%	2.23%	552	228	19	41.30%	8.33%
WI	25,961	12,854	64	61	50.23%	0.47%	5,242	2,562	41	48.87%	1.60%	561	269	26	47.95%	9.67%
WV	21,945	4,281	64	18	1.49%	28.13%	1,124	44	11	3.91%	25.00%	100	6	4	6.00%	66.67%
WY	36,665	2,441	1,237	9	50.66%	0.73%	632	346	5	54.75%	1.45%	41	21	4	51.22%	19.05%
TOTAL	805,414	282,383	5,688	5,688			206,609	80,030	3,051			24,969	9,588	1,189		

Table 2 lists the formation state for out-of-state or foreign LLCs (FLLCs).⁹⁹ The table shows that Delaware is the clear leader, with a 25% share of all FLLC formations. Florida is second, with just over 9% of the out-of-state formations, and Nevada third with 7.6% of the out-of-state formations. No other state has as much as a 5% share of out-of-state formations. Delaware is even more dominant for large firms. Table 2 lists the destination states for firms with five or more and fifty or more employees. Delaware has a 61.7% share of out-of-state formations of the largest firms, while Florida and Nevada have 2.34% and 2.09% respectively.

Table 2
Destination State of Foreign LLC Formations

State	All LLCs		LLCs with 5 or More Employees		LLCs with 50 or More Employees	
	Number of FLLCs	% of Total FLLCs	Number of FLLCs	% of Total FLLCs	Number of FLLCs	% of Total FLLCs
AK	36	0.63%	19	0.62%	4	0.33%
AL	34	0.60%	18	0.59%	5	0.42%
AR	19	0.33%	9	0.29%	5	0.42%
AZ	138	2.42%	44	1.44%	4	0.33%
CA	200	3.51%	91	2.98%	22	1.84%
CO	16	0.28%	11	0.36%	5	0.42%
CT	158	2.77%	41	1.34%	10	0.84%
DC	30	0.53%	15	0.49%	0	0.00%
DE	1,461	25.65%	1,210	39.58%	737	61.67%
FL	514	9.02%	148	4.84%	28	2.34%
GA	180	3.16%	81	2.65%	25	2.09%
HI	22	0.39%	9	0.29%	1	0.08%
IA	67	1.18%	23	0.75%	4	0.33%
ID	55	0.97%	22	0.72%	5	0.42%
IL	97	1.70%	48	1.57%	15	1.26%
IN	83	1.46%	41	1.34%	20	1.67%

(Continued on next page)

99. Table 1 indicates that the rate at which the formation state is reported varies widely by state, with several states, including Rhode Island, West Virginia, and Colorado, reporting rates of 5% or less. These three states have the highest percentages of out-of-state formations, and are also states that are coded as lax states. Moreover, all but one (DC) of the seven states that report out-of-state formation rates of greater than 10% have the lowest reporting rates, and all seven are coded by Dammann and Schündeln as lax states. This suggests that the propensity of firms in the low reporting states to organize out of state may be an artifact of the low reporting rate. The higher out-of-state formation rate in these states may reflect a higher probability that an out-of-state firm reports its state of formation rather than some inherent difference in these states. When we ran Dammann and Schündeln's regressions and corrected for the low reporting rate states, or when they are run with the assumption that a missing formation state means the firm formed in the home state, the coefficients on the Dammann and Schündeln care variables are no longer statistically significant.

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Table 2—Continued

State	All LLCs		LLCs with 5 or More Employees		LLCs with 50 or More Employees	
	Number of FLLCs	% of Total FLLCs	Number of FLLCs	% of Total FLLCs	Number of FLLCs	% of Total FLLCs
KS	77	1.35%	29	0.95%	4	0.33%
KY	63	1.11%	25	0.82%	6	0.50%
LA	18	0.32%	9	0.29%	2	0.17%
MA	64	1.12%	29	0.95%	4	0.33%
MD	182	3.19%	77	2.52%	19	1.59%
ME	13	0.23%	6	0.20%	3	0.25%
MI	36	0.63%	24	0.79%	7	0.59%
MN	41	0.72%	33	1.08%	12	1.00%
MO	82	1.44%	37	1.21%	11	0.92%
MS	37	0.65%	16	0.52%	2	0.17%
MT	21	0.37%	7	0.23%	1	0.08%
NC	150	2.63%	60	1.96%	24	2.01%
ND	7	0.12%	3	0.10%	1	0.08%
NE	16	0.28%	9	0.29%	2	0.17%
NH	25	0.44%	4	0.13%	0	0.00%
NJ	45	0.79%	31	1.01%	8	0.67%
NM	47	0.82%	17	0.56%	1	0.08%
NV	434	7.62%	195	6.38%	25	2.09%
NY	89	1.56%	63	2.06%	18	1.51%
OH	133	2.33%	66	2.16%	25	2.09%
OK	31	0.54%	12	0.39%	3	0.25%
OR	58	1.02%	25	0.82%	7	0.59%
PA	89	1.56%	49	1.60%	16	1.34%
RI	3	0.05%	3	0.10%	1	0.08%
SC	34	0.60%	16	0.52%	3	0.25%
SD	13	0.23%	9	0.29%	4	0.33%
TN	95	1.67%	60	1.96%	17	1.42%
TX	132	2.32%	75	2.45%	24	2.01%
UT	38	0.67%	17	0.56%	4	0.33%
VA	244	4.28%	107	3.50%	30	2.51%
VT	4	0.07%	0	0.00%	0	0.00%
WA	41	0.72%	24	0.79%	6	0.50%
WI	87	1.53%	28	0.92%	6	0.50%
WV	5	0.09%	4	0.13%	0	0.00%
WY	133	2.33%	58	1.90%	9	0.75%
Total	5697		3057		1195	

C. Regression Analysis

We performed a cross-sectional regression analysis of the ICARUS data in order to systematically examine the factors that affect LLCs' decisions to form out of state.¹⁰⁰ The dependent variable HOME takes the value one if the LLC forms in the home state, zero if it forms in a state other than the home state. Tables 3 and 4 report the marginal effects of the independent variables on the probability of formation in the home state.

Table 3 reports regression results from six different sets, or specifications, of variables. One excludes the Dammann and Schündeln variables, and one includes them, each with three "law quality" variables, which are described in more detail below. Specifications (1) and (2) use the COC Ranking, (3) and (4) use the CGP court influence and productivity measures, and (5) and (6) use the number of LLC decisions. Table 3A reports the results for all firms in the dataset regardless of size, Table 3B the results for firms having five or more employees,¹⁰¹ and Table 3C the results for firms having fifty or more employees.

100. Following Dammann and Schündeln, we used a probit estimation procedure with robust standard errors clustered by state. See Dammann & Schündeln, *supra* note 43, at 17. We attempted to replicate Dammann and Schündeln's results reported in their Table 3. See *id.* at 18. As discussed above, we were not able to replicate the dataset used by Dammann and Schündeln because of ICARUS's monthly updates. Despite the differences in the datasets, our regressions are largely consistent with the basic Dammann and Schündeln regressions. When we used a dataset with 2006 data and LLCs with five or more employees, both the care 1 variable (denoting states whose statutes contain an explicit gross negligence standard) and the care 2 variable (denoting states that explicitly allow waiver of the duty of care) are negative and statistically significant. The Dammann and Schündeln care 3 variable (denoting states that have a gross negligence standard or allow waiver) is negative, indicating that firms are less likely to form at home if the home statute is lax, but this finding is not significant. One notable difference between our regressions and Dammann and Schündeln's is the effect of the dissolution variable. This variable denotes states that allow a sub-unanimous vote to dissolve. In Dammann and Schündeln's basic regressions, this variable is negative and significant. See *id.* at 19–20. The variable is positive in our regressions but not significant. We found, as did Dammann and Schündeln, that the court quality variable was not significant in any of their regressions.

101. Dammann and Schündeln's main regressions are based on firms having five or more employees. See Dammann & Schündeln, *supra* note 43, at 6.

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Table 3A
Probit Regression Analysis (All Observations)

ALL OBSERVATIONS (N = 281,422)						
	(1)	(2)	(3)	(4)	(5)	(6)
STATE LEVEL VARIABLES						
Low Reporting Rate	-0.082*** (-8.71)	-0.079*** (-11.28)	-0.080*** (-9.05)	-0.068*** (-11.78)	0.083*** (-9.05)	-0.078*** (-11.00)
Log(Revenue)	-0.003*** (-8.31)	-0.003*** (-8.31)	-0.003*** (-9.19)	-0.003*** (-9.10)	0.003*** (-9.26)	-0.003*** (-8.93)
Log(Employees)	-0.001** (-2.40)	-0.001** (-2.41)	-0.001*** (-2.81)	-0.001*** (-2.95)	0.001*** (-3.11)	-0.001*** (-3.18)
Log(Total State Population)	-0.002 (-1.10)	0.001 (0.38)	-0.002 (-0.98)	0.001 (0.70)	0.001 (-0.88)	0.002 (1.59)
Total State Establishments	-0.001 (-0.68)	-0.002** (-2.04)	-0.001 (-0.67)	-0.002** (-2.16)	0.001 (1.55)	-0.002** (-1.97)
State GDP	-1.1E-07 (-0.66)	4.61E-08 (0.34)	-3.3E-08 (-0.23)	9.4E-08 (0.82)	-1.7E-07 (-1.05)	-2.3E-08 (-0.18)
Northeast	0.001 (0.48)	-0.003 (-1.50)	0.002 (0.77)	-0.003 (-1.30)	0.002 (0.65)	0.003 (1.14)
South	-0.002 (-1.27)	-0.005*** (-2.65)	-0.002 (-0.96)	-0.004** (-2.52)	-0.002 (-0.94)	-0.004** (2.23)
West	0.002 (1.08)	0.002 (0.72)	0.004* (1.81)	0.004** (2.09)	0.005* (1.77)	0.004 (1.54)
LLC Age Home State	0.003 (1.22)	0.003 (1.32)	0.003 (1.09)	0.003 (1.16)	0.003 (1.13)	0.003 (0.98)
LLC Age Formation State	-0.003 (-0.97)	-0.003 (-1.04)	-0.003 (-0.81)	-0.002 (-0.80)	-0.003 (-0.83)	-0.002 (-0.71)
LAW QUALITY VARIABLES						
COC Court Quality Home State	0.002** (2.01)	0.002** (2.03)				
COC Court Quality Formation State	-0.003** (-2.02)	-0.002** (-2.23)				
CGP Court Influence Home State			0.002 (0.56)	0.000 (0.16)		
CGP Court Influence Formation State			-0.002 (-0.69)	-0.001 (-0.25)		
CGP Ct. Productivity Home State			-0.001 (-0.49)	0.001 (0.54)		
CGP Ct. Productivity Formation State			0.001 (0.62)	-0.000 (-0.26)		
LLC Decisions Home State				0.001 (0.062)	0.000 (0.15)	
LLC Decisions Formation State				-0.001 (-0.46)	0.000 (0.01)	
INNOVATION VARIABLES						
Series Home State	0.012 (1.10)	0.013 (1.60)	0.013 (1.19)	0.016** (2.31)	0.014* (1.67)	0.016** (2.42)
Series Formation State	-0.062 (-1.27)	-0.099* (-1.76)	-0.90 (-1.40)	-0.240** (-2.39)	-0.131* (-1.92)	-0.220*** (-2.58)

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Table 3A—Continued

ALL OBSERVATIONS (N = 281,422)						
	(1)	(2)	(3)	(4)	(5)	(6)
STATUTORY FLEXIBILITY VARIABLES						
Statutory Flexibility	0.005	0.007	0.001	0.004	0.005	0.004
Home State	(0.68)	(0.93)	(0.11)	(0.51)	(0.65)	(0.55)
Statutory Flexibility	-0.005	-0.007	-0.000	-0.003	-0.004	-0.003
Formation State	(-0.56)	(-0.78)	(-0.03)	(-0.29)	(-0.45)	(-0.36)
UNIFORMITY VARIABLES						
TP Adoptions	-0.003	0.002	-0.004	0.002	-0.004	0.001
Home State	(-0.82)	(0.36)	(-1.18)	(0.45)	(-1.19)	(0.18)
TP Adoptions	0.004	-0.001	0.006	-0.001	0.006	-0.000
Formation State	(1.09)	(-0.15)	(1.45)	(-0.17)	(1.44)	(-0.07)
Tax Adoptions	0.000	0.001	-0.001	0.001	-0.000	0.001
Home State	(0.06)	(0.73)	(-0.62)	(0.47)	(-0.39)	(0.55)
Tax Adoptions	-0.000	-0.001	0.000	-0.001	0.000	-0.001
Formation State	(-0.29)	(-0.91)	(0.35)	(-0.63)	(0.09)	(-0.75)
Member Adoptions	-0.001	-0.002	0.001	-0.002	0.001	-0.001
Home State	(-0.26)	(-0.45)	(0.28)	(-0.39)	(0.16)	(-0.26)
Member Adoptions	0.001	0.002	-0.002	0.002	-0.001	0.001
Formation State	(0.20)	(0.41)	(-0.34)	(0.29)	(-0.22)	(0.25)
CREDITOR PROTECTION VARIABLES						
Charging Order	-0.003	0.001	0.003	0.004	0.005	0.005
Home State	(-0.14)	(0.05)	(0.16)	(0.19)	(0.26)	(0.28)
Charging Order	0.005	0.001	-0.002	-0.004	-0.005	-0.007
Formation State	(0.22)	(0.06)	(-0.07)	(-0.10)	(-0.15)	(-0.23)
DAMMANN & SCHÜNDELN VARIABLES						
Care 3 (revised)		-0.015		-0.014		-0.014
Home State		(-1.46)		(-1.21)		(-1.23)
Care 3 (revised)		0.107		0.072		0.075
Formation State		(1.44)		(1.12)		(1.24)
Withdraw (revised)		0.005		-0.003		-0.000
Home State		(0.23)		(-0.17)		(-0.01)
Withdraw (revised)		-0.007		-0.001		-0.004
Formation State		(-0.39)		(-0.03)		(-0.18)
Dissolution (revised)		0.008		0.007		0.008
Home State		(0.54)		(0.46)		(0.54)
Dissolution (revised)		-0.008		-0.007		-0.010
Formation State		(-0.46)		(-0.37)		(-0.51)
Pierce LLC		-0.029		-0.056*		-0.051*
Home State		(-1.30)		(-1.85)		(-1.76)
Pierce LLC		0.015		0.023*		0.021
Formation State		(1.14)		(1.66)		(1.58)
ULLCA		0.003		-0.024		-0.027
Home State		(0.19)		(-0.70)		(-0.72)
ULLCA		-0.013		0.009		0.009
Formation State		(-0.37)		(0.54)		(0.55)

Dependent Variable: HOME = 1 if LLC forms in the home state, 0 if it forms out of state.

Table entries report marginal effects (z-statistics of underlying coefficients based in parentheses).

* denotes significant at the .10 level.

** denotes significant at the .05 level.

*** denotes significant at the .01 level.

No. 1]

DELAWARE FOR SMALL FRY

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Table 3B
Probit Regression Analysis (Five or More Employees)

FIRMS WITH FIVE OR MORE EMPLOYEES (N = 79,711)						
	(1)	(2)	(3)	(4)	(5)	(6)
STATE LEVEL VARIABLES						
Low Reporting Rate	-0.066*** (-8.75)	-0.064*** (-9.98)	-0.062*** (-9.64)	-0.055*** (-11.19)	0.065*** (-8.65)	-0.064*** (-9.18)
Log(Revenue)	-0.005*** (-7.19)	-0.005*** (-7.15)	-0.005*** (-8.17)	-0.005*** (-7.54)	0.005*** (-7.97)	-0.005*** (-7.56)
Log(Employees)	-0.003*** (-4.60)	-0.003*** (-4.36)	-0.004*** (-5.42)	-0.004*** (-5.17)	0.004*** (-5.33)	-0.004*** (-5.24)
Log(Total State Population)	-0.001 (-0.38)	0.003 (0.99)	-0.001 (-0.42)	0.004 (1.42)	0.000 (0.05)	-0.003 (-1.16)
Total State Establishments	-0.001 (-1.23)	-0.003** (-2.27)	-0.001 (-0.83)	-0.003** (-2.40)	-0.003** (-2.06)	-0.004** (2.38)
State GDP	-1.2E-07 (-0.52)	4.89E-08 (0.22)	7.8E-08 (0.40)	2.0E-07 (1.19)	-2.4E-07 (-1.04)	-4.2E-08 (-0.20)
Northeast	0.004 (1.04)	-0.001 (-0.37)	0.000 (0.11)	-0.001 (-0.37)	0.005 (1.20)	-0.001 (-0.47)
South	-0.004 (-1.27)	-0.007** (-2.18)	-0.004 (-1.24)	-0.007*** (-2.91)	-0.003 (-0.88)	-0.006** (-2.12)
West	0.008** (2.47)	0.009** (2.43)	0.012*** (3.54)	0.014** (4.29)	0.013*** (2.97)	0.012*** (3.14)
LLC Age Home State	0.004 (0.89)	0.004 (1.05)	0.004 (0.84)	0.004 (0.93)	0.004 (0.88)	0.003 (0.75)
LLC Age Formation State	-0.003 (-0.65)	-0.004 (-0.78)	-0.003 (-0.60)	-0.003 (-0.55)	-0.003 (-0.57)	-0.0027 (-0.47)
LAW QUALITY VARIABLES						
COC Court Quality Home State	0.003** (2.00)	0.003** (2.19)				
COC Court Quality Formation State	-0.004** (-2.02)	-0.004** (-2.34)				
CGP Court Influence Home State			0.003 (0.56)	0.002 (0.38)		
CGP Court Influence Formation State			-0.005 (-0.84)	-0.003 (-0.63)		
CGP Ct. Productivity Home State			-0.001 (-0.24)	0.001 (0.57)		
CGP Ct. Productivity Formation State			0.001 (0.46)	-0.001 (-0.19)		
LLC Decisions Home State					0.001 (0.59)	0.000 (0.14)
LLC Decisions Formation State					-0.001 (-0.40)	0.000 (0.05)
INNOVATION VARIABLES						
Series Home State	0.024* (1.66)	0.025** (2.06)	0.026* (1.82)	0.031*** (2.74)	0.028** (2.38)	0.031*** (2.99)
Series Formation State	-0.127* (-1.66)	-0.162** (-2.03)	-0.181* (-1.85)	-0.341*** (-2.64)	-0.248** (-2.47)	-0.339*** (-2.95)

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Table 3B—Continued

FIRMS WITH FIVE OR MORE EMPLOYEES (N = 79,711)						
	(1)	(2)	(3)	(4)	(5)	(6)
STATUTORY FLEXIBILITY VARIABLES						
Statutory Flexibility	0.004	0.007	-0.003	0.001	0.004	0.003
Home State	(0.34)	(0.67)	(-0.26)	(0.08)	(0.30)	(0.25)
Statutory Flexibility	-0.004	-0.008	0.004	0.001	-0.003	-0.002
Formation State	(-0.31)	(-0.59)	(0.27)	(0.09)	(-0.22)	(-0.13)
UNIFORMITY VARIABLES						
TP Adoptions	-0.005	0.001	-0.007	0.002	-0.007	-0.000
Home State	(-0.93)	(0.20)	(-1.33)	(0.22)	(-1.37)	(-0.03)
TP Adoptions	0.007	-0.000	0.010	0.000	0.009	-0.001
Formation State	(1.13)	(-0.02)	(1.50)	(0.02)	(1.48)	(-0.09)
Tax Adoptions	0.000	0.001	0.002	0.000	-0.001	0.000
Home State	(-0.17)	(0.45)	(-0.96)	(0.03)	(-0.62)	(0.27)
Tax Adoptions	0.000	-0.002	0.001	-0.001	0.000	-0.001
Formation State	(-0.21)	(-0.74)	(0.56)	(-0.32)	(0.16)	(-0.62)
Member Adoptions	-0.007	-0.008	-0.003	-0.008	-0.005	-0.007
Home State	(-1.05)	(-1.20)	(-0.45)	(-1.04)	(-0.66)	(-1.00)
Member Adoptions	0.007	0.009	0.003	0.008	0.004	0.008
Formation State	(0.84)	(1.02)	(0.29)	(0.83)	(0.46)	(0.85)
CREDITOR PROTECTION VARIABLES						
Charging Order	0.008	0.011	0.014	0.013	0.016	0.017
Home State	(0.33)	(0.45)	(0.48)	(0.44)	(0.63)	(0.72)
Charging Order	-0.009	-0.013	-0.022	-0.016	-0.035	-0.040
Formation State	(-0.21)	(-0.28)	(-0.36)	(-0.27)	(-0.53)	(-0.61)
DAMMANN & SCHÜNDELN VARIABLES						
Care 3 (revised)		-0.025		-0.021		-0.022
Home State		(-1.35)		(-1.01)		(-1.13)
Care 3 (revised)		0.125		0.068		0.089
Formation State		(1.34)		(0.90)		(1.15)
Withdraw (revised)		0.007		-0.008		-0.000
Home State		(0.23)		(-0.32)		(-0.01)
Withdraw (revised)		-0.011		0.004		-0.006
Formation State		(-0.36)		(0.10)		(-0.19)
Dissolution (revised)		0.008		0.003		0.010
Home State		(0.36)		(0.12)		(0.40)
Dissolution (revised)		-0.008		-0.001		-0.012
Formation State		(-0.28)		(-0.02)		(-0.39)
Pierce LLC		-0.030		-0.060		-0.055
Home State		(-1.02)		(-1.62)		(-1.53)
Pierce LLC		0.021		0.035		0.032
Formation State		(0.85)		(1.47)		(1.34)
ULLCA		0.012		-0.019		-0.029
Home State		(0.47)		(-0.45)		(-0.58)
ULLCA		-0.033		0.012		0.015
Formation State		(-0.54)		(0.39)		(0.50)

Dependent Variable: HOME = 1 if LLC forms in the home state, 0 if it forms out of state.

Table entries report marginal effects (z-statistics of underlying coefficients based in parentheses).

* denotes significant at the .10 level.

** denotes significant at the .05 level.

*** denotes significant at the .01 level.

Table 3C
Probit Regression Analysis (Fifty or More Employees)

FIRMS WITH 50 OR MORE EMPLOYEES (N = 9,555)						
	(1)	(2)	(3)	(4)	(5)	(6)
STATE LEVEL VARIABLES						
Low Reporting Rate	-0.066*** (-3.81)	-0.055*** (-3.69)	-0.064*** (-3.61)	-0.045*** (-3.80)	-0.064*** (-4.45)	-0.060*** (-4.75)
Log(Revenue)	-0.012*** (-2.86)	-0.011*** (-2.78)	-0.012*** (-2.92)	-0.011*** (-2.87)	-0.013*** (-2.84)	-0.012*** (-2.77)
Log(Employees)	-0.018*** (-3.30)	-0.019*** (-3.72)	-0.021*** (-3.90)	-0.020*** (-3.84)	-0.021*** (-4.04)	-0.020*** (-4.17)
Log(Total State Population)	-0.009 (-0.72)	-0.006 (-0.54)	-0.006 (-0.42)	0.001 (0.07)	-0.006 (-0.46)	-0.001 (-0.08)
Total State Establishments	0.006 (1.06)	0.005 (0.86)	0.004 (0.59)	0.001 (0.19)	0.001 (0.16)	-0.000 (-0.00)
State GDP	-6.5E-07 (-0.67)	-3.8E-07 (-0.38)	-2.5E-07 (-0.28)	5.7E-07 (0.63)	-7.4E-07 (-0.80)	-1.2E-07 (-0.13)
Northeast	0.016 (1.31)	0.004 (0.35)	0.024** (2.20)	0.002 (0.16)	0.022** (2.04)	0.002 (0.18)
South	0.007 (0.63)	0.017 (1.38)	0.011 (0.91)	0.009 (0.76)	0.009 (0.82)	0.004 (0.38)
West	0.024 (1.55)	0.044*** (4.04)	0.032** (1.97)	0.044** (3.46)	0.042** (2.39)	0.049*** (3.55)
LLC Age Home State	0.010 (1.14)	0.014 (1.40)	0.015 (1.48)	0.016 (1.42)	0.011 (1.25)	0.010 (1.03)
LLC Age Formation State	-0.012 (-0.93)	-0.017 (-1.26)	-0.016 (-1.25)	-0.016 (-1.16)	-0.011 (-0.86)	-0.010 (-0.75)
LAW QUALITY VARIABLES						
COC Court Quality Home State	0.010** (2.42)	0.014*** (3.28)				
COC Court Quality Formation State	-0.013** (-2.41)	-0.017*** (-3.04)				
CGP Court Influence Home State			0.021 (1.62)	0.024** (1.97)		
CGP Court Influence Formation State			-0.028 (-1.64)	-0.030* (-1.89)		
CGP Ct. Productivity Home State			0.002 (0.030)	0.006 (0.94)		
CGP Ct. Productivity Formation State			-0.002 (-0.19)	0.005 (-0.59)		
LLC Decisions Home State				0.004 (0.87)	0.001 (0.32)	
LLC Decisions Formation State				-0.004 (-0.65)	-0.001 (-0.10)	
INNOVATION VARIABLES						
Series Home State	0.093** (2.29)	0.095** (2.29)	0.105** (2.50)	0.122*** (3.12)	0.108*** (3.13)	0.119*** (3.46)
Series Formation State	-0.281** (-1.98)	-0.260* (-1.77)	-0.382** (-2.18)	-0.549** (-2.64)	-0.475*** (-2.89)	-0.571*** (-3.08)

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Table 3C—Continued

FIRMS WITH 50 OR MORE EMPLOYEES (N = 9,555)						
	(1)	(2)	(3)	(4)	(5)	(6)
STATUTORY FLEXIBILITY VARIABLES						
Statutory Flexibility	0.167	0.037	-0.009	-0.003	0.017	0.014
Home State	(0.48)	(1.12)	(-0.24)	(-0.08)	(0.45)	(0.40)
Statutory Flexibility	-0.241	-0.043	-0.004	0.008	-0.022	-0.015
Formation State	(-0.54)	(-1.00)	(-0.31)	(0.15)	(-0.47)	(-0.33)
UNIFORMITY VARIABLES						
TP Adoptions	-0.007	0.015	-0.008	0.022	-0.016	0.007
Home State	(-0.49)	(0.68)	(-0.54)	(0.95)	(-1.10)	(0.34)
TP Adoptions	0.012	-0.010	0.012	-0.018	0.021	-0.005
Formation State	(0.62)	(-0.37)	(0.63)	(-0.61)	(1.13)	(-0.18)
Tax Adoptions	-0.003	0.001	-0.010*	-0.004	-0.006	-0.001
Home State	(-0.61)	(0.13)	(-1.76)	(-0.65)	(-1.17)	(-0.13)
Tax Adoptions	0.001	-0.001	0.009	0.004	0.004	-0.001
Formation State	(0.24)	(-0.20)	(1.36)	(0.50)	(0.66)	(-0.14)
Member Adoptions	-0.020	-0.030	-0.013	-0.030	-0.016	-0.026
Home State	(-1.04)	(-1.46)	(-0.60)	(-1.40)	(-0.80)	(-1.25)
Member Adoptions	0.025	0.032	0.015	0.033	0.018	0.029
Formation State	(0.95)	(1.16)	(0.53)	(1.13)	(0.68)	(1.03)
CREDITOR PROTECTION VARIABLES						
Charging Order	0.022	0.024	0.015	-0.001	0.045	0.049
Home State	(0.28)	(0.28)	(0.15)	(-0.01)	(0.59)	(0.63)
Charging Order	-0.611	-0.063	-0.054	-0.026	-0.131	-0.136
Formation State	(-0.45)	(-0.45)	(-0.32)	(-0.16)	(-0.77)	(-0.78)
DAMMANN & SCHÜNDELN VARIABLES						
Care 3 (revised)		-0.093*		-0.070		-0.076
Home State		(-1.65)		(-1.01)		(-1.25)
Care 3 (revised)		0.294		0.138		0.203
Formation State		(1.41)		(0.78)		(1.12)
Withdraw (revised)		0.050		-0.041		0.015
Home State		(0.54)		(-0.54)		(0.17)
Withdraw (revised)		-0.059		0.031		-0.046
Formation State		(-0.68)		(0.26)		(-0.49)
Dissolution (re-		0.020		-0.049		0.018
vised)		(0.30)		(-0.64)		(0.25)
Home State						
Dissolution (re-		-0.026		0.056		-0.033
vised)		(-0.29)		(0.57)		(-0.34)
Formation State						
Pierce LLC		-0.070		-0.180*		-0.139
Home State		(-0.89)		(-1.92)		(-1.55)
Pierce LLC		0.035		0.112		0.093
Formation State		(0.41)		(1.46)		(1.19)
ULLCA		0.087		0.039		-0.025
Home State		(1.58)		(0.51)		(-0.23)
ULLCA		-0.249		-0.034		0.042
Formation State		(-1.19)		(-0.26)		(0.39)

Dependent Variable: HOME = 1 if LLC forms in the home state, 0 if it forms out of state.

Table entries report marginal effects (z-statistics of underlying coefficients based in parentheses).

* denotes significant at the .10 level.

** denotes significant at the .05 level.

*** denotes significant at the .01 level.

Table 4 reports the results when variables denoting whether an LLC is located in Delaware and whether it forms in Delaware are added to specifications (1) and (2) in Table 3. Columns (1) and (2) in Table 4 report the results for all firms in the dataset regardless of size, (3) and (4) report the results for firms having five or more employees, and columns (5) and (6) report the results for firms with fifty or more employees.¹⁰² Explanatory variables include firm size, measured by both the log of the number of employees and the log of total revenues. We also control for state population, the number of establishments in a state, the state's gross domestic product, region fixed effects, the LLC statute's age, and for states where the rate of LLCs that reported their state of formation was below 6%.¹⁰³

Table 4
Probit Regression Analysis

	ALL OBSERVATIONS (N = 281,422)		FIRMS WITH 5 OR MORE EMPLOYEES (N = 79,711)		FIRMS WITH 50 OR MORE EMPLOYEES (N = 9,555)	
	(1)	(2)	(3)	(4)	(5)	(6)
STATE LEVEL VARIABLES						
Low Rate	-0.080*** (-8.66)	-0.080*** (-11.00)	-0.066*** (-9.34)	-0.066*** (-9.80)	0.083*** (-1.86)	-0.070*** (-4.81)
Log (Revenue)	-0.003*** (-8.22)	-0.003*** (-8.04)	-0.005*** (-7.35)	-0.005*** (-7.08)	0.012** (-2.44)	-0.012*** (-2.58)
Log (Employees)	-0.001 (-0.63)	-0.001* (-1.77)	-0.003*** (-4.16)	-0.003*** (-3.89)	-0.021*** (-3.35)	-0.020*** (-3.45)

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102. All of the regressions contained one-digit SIC industry fixed effects that were not reported in Tables 3 and 4. Our dataset contains a broad range of firms. Our analysis did not attempt to determine whether some types of firms were more likely to form out of state than others, other than controlling for a firm's one-digit SIC code. Based on the results from the one-digit SIC code dummy variables, firms in the 2000–2999 range (manufacturing) were more likely to form in their home state, all things equal, than firms in the 4000–4999 (transportation) and 7000–7999 (services) range.

103. These include CO, DE, LA, MI, NJ, NY, RI, and WV. All other states had overall reporting rates above 27%. As noted *supra* note 99, all of the low reporting states also have significantly higher out-of-state formation rates. See *supra* Table 1. A random sample of CO and NJ LLCs that did not report their states of formation found much lower rates of out-of-state formations than in the reported data. For example, a random sample of 301 nonreporting CO LLCs found 8 LLCs that formed outside the home state, 186 LLCs that formed in the home state, 87 LLCs that dissolved or were no longer LLCs, and 20 firms that could not be located. The out-of-state reporting rate from this sample was 4.3%, compared to the 23.42% rate from the reported data. In the NJ sample there were 7 out-of-state LLCs, 308 in-state LLCs, and 43 LLCs that dissolved or could not be found. The out-of-state formation rate of this sample was 2.27%, compared to the 19.37% rate from the reported data. This suggests that in-state LLCs fail to report the formation state more frequently than LLCs that form out of state and that the out-of-state formation rate in the reported data for low reporting rate states may be artificially high. In regressions that did not include a low reporting-rate variable and where LLCs that did not report a formation state were assumed to be in-state LLCs, the substantive results are the same but some statistically insignificant results reported in this paper become significant.

Table 4—Continued

	ALL OBSERVATIONS (N = 281,422)		FIRMS WITH 5 OR MORE EMPLOYEES (N = 79,711)		FIRMS WITH 50 OR MORE EMPLOYEES (N = 9,555)	
	(1)	(2)	(3)	(4)	(5)	(6)
Log(Total State Population)	-0.001 (-0.63)	-0.001 (-0.42)	0.000 (0.12)	-0.002 (-0.94)	0.004 (0.31)	-0.004 (-0.30)
Total State Estab- lishments	0.001 (0.00)	-0.002* (-1.88)	-0.002 (-1.72)	-0.003** (-2.08)	0.001 (0.16)	0.006** (0.98)
State GDP	5.36E-08 (0.32)	5.59E-08 (0.40)	-3.59E-08 (-0.15)	7.26E-08 (0.32)	-8.49E-07 (-0.79)	-6.5E-07 (0.60)
Northeast	0.001 (0.42)	-0.002 (-1.17)	0.003 (0.84)	-0.000 (-0.12)	0.017 (1.28)	0.010 (0.74)
South	0.002 (1.00)	-0.002** (-2.15)	-0.003 (-1.10)	0.006* (-1.69)	0.005 (0.42)	0.019 (1.33)
West	0.002 (1.05)	0.002 (0.79)	0.008*** (2.66)	0.009** (2.50)	0.029 (1.70)	0.046*** (4.04)
LLC Age Home State	0.003 (1.01)	0.003 (1.07)	0.003 (0.66)	0.003 (0.78)	0.010 (0.94)	0.013 (1.06)
LLC Age Formation State	-0.003 (-0.80)	-0.003 (-0.82)	-0.003 (-0.48)	-0.003 (-0.57)	-0.011 (-0.78)	-0.015 (-0.99)
LAW QUALITY VARIABLES						
COC Court Quality Home State	0.001 (0.74)	0.001 (0.72)	0.001 (0.64)	0.001 (0.75)	0.001 (0.09)	0.005 (0.84)
COC Court Quality Formation State	-0.001 (-0.71)	-0.001 (-0.85)	-0.002 (-0.64)	-0.002 (-0.83)	-0.001 (-0.13)	-0.005 (-0.66)
Delaware Home State	0.011** (2.33)	0.011** (1.96)	0.020** (2.33)	0.020** (1.99)	0.090*** (3.86)	0.089*** (3.53)
Delaware Formation State	-0.920*** (-2.44)	-0.788** (-2.02)	-0.915** (-2.46)	-0.847** (-2.14)	-0.956*** (-3.18)	-0.953*** (-3.06)
INNOVATION VARIABLES						
Series Home State	0.005 (0.28)	0.010 (0.92)	0.016 (0.73)	0.021 (1.19)	0.053 (0.78)	0.071 (1.10)
Series Formation State	-0.013 (-0.44)	-0.046 (-1.03)	-0.039 (-0.73)	-0.076 (-1.15)	-0.067 (-0.55)	-0.091 (-0.68)
STATUTORY FLEXIBILITY VARIABLES						
Statutory Flexibility Home State	0.003 (0.32)	-0.000 (-0.01)	-0.009 (-0.70)	-0.005 (-0.40)	-0.041 (-1.04)	-0.022 (-0.61)
Statutory Flexibility Formation State	0.004 (0.43)	0.001 (0.11)	0.011 (0.73)	0.007 (0.44)	0.047 (0.93)	0.027 (0.57)
UNIFORMITY VARIABLES						
TP Adoptions Home State	-0.004 (-1.22)	0.000 (0.08)	-0.007 (-1.39)	-0.001 (-0.17)	-0.013 (-0.81)	0.009 (0.37)
TP Adoptions Formation State	0.006 (1.44)	0.001 (0.12)	0.010 (1.51)	0.003 (0.29)	0.018 (0.92)	-0.003 (-0.10)
Tax Adoptions Home State	0.001 (-0.70)	0.000 (0.09)	-0.002 (-1.07)	-0.001 (-0.36)	-0.011 (-1.64)	-0.006 (-0.93)
Tax Adoptions Formation State	0.001 (0.53)	-0.000 (-0.25)	0.002 (0.76)	0.000 (0.10)	0.011 (1.39)	0.007 (0.87)
Member Adoptions Home State	0.001 (0.30)	-0.000 (-0.25)	-0.003 (-0.70)	-0.005 (-0.074)	-0.003 (-0.13)	-0.016 (-0.71)
Member Adoptions Formation State	-0.002 (-0.32)	0.000 (0.02)	0.004 (0.30)	0.005 (0.61)	0.004 (0.15)	0.016 (0.54)

(Continued on next page)

Table 4—*Continued*

	ALL OBSERVATIONS (N = 281,422)		FIRMS WITH 5 OR MORE EMPLOYEES (N = 79,711)		FIRMS WITH 50 OR MORE EMPLOYEES (N = 9,555)	
	(1)	(2)	(3)	(4)	(5)	(6)
CREDITOR PROTECTION VARIABLES						
Charging Order Home State	-0.019 (-0.64)	-0.006 (-0.25)	-0.008 (-0.22)	0.003 (0.10)	-0.033 (-0.31)	-0.007 (-0.07)
Charging Order Formation State	0.011 (0.68)	0.007 (0.35)	0.010 (0.29)	0.001 (0.03)	0.011 (0.09)	-0.019 (-0.14)
DAMMANN & SCHÜNDELN VARIABLES						
Care 3 (revised) Home State		-0.014 (-1.20)		-0.023 (-1.07)		-0.090 (-1.23)
Care 3 (revised) Formation State		0.077 (1.19)		0.089 (1.07)		0.219 (1.06)
Withdraw (revised) Home State		-0.002 (-0.10)		-0.004 (-0.15)		0.002 (0.02)
Withdraw (revised) Formation State		-0.002 (-0.08)		-0.000 (-0.01)		-0.018 (-0.16)
Dissolution (re- vised) Home State		0.000 (0.02)		-0.006 (-0.26)		-0.044 (-0.55)
Dissolution (re- vised) Formation State		-0.001 (-0.03)		0.008 (0.28)		0.045 (0.45)
Pierce LLC Home State		-0.022 (-1.03)		-0.017 (-0.62)		-0.037 (-0.44)
Pierce LLC Formation State		0.013 (0.88)		0.013 (0.49)		0.004 (0.04)
ULLCA Home State		0.003 (0.13)		0.006 (0.18)		0.085 (1.15)
ULLCA Formation State		-0.001 (-0.03)		-0.011 (-0.22)		-0.160 (-0.79)

Dependent Variable: HOME = 1 if LLC forms in the home state, 0 if it forms out of state.

Table entries report marginal effects (z-statistics of underlying coefficients based in parentheses).

* denotes significant at the .10 level.

** denotes significant at the .05 level.

*** denotes significant at the .01 level.

Based on the discussion above in Part III.B, we include several groups of state law and court independent variables: the COC court quality variable used by Dammann and Schündeln as well as the alternative CGP and number of LLC decisions measures, and statutory variables related to innovation, protection for debtors, uniformity, and statutory flexibility. The even-numbered specifications add the Dammann and Schündeln variables relating to “laxity” and uniform law adoption.

It is important to emphasize that our analysis relates to firms’ decisions both to remain in their home state and to organize elsewhere. Thus, in testing whether a firm organizes outside its home state, we control for the attributes of the statutes and legal environment in the *forma-*

tion state.¹⁰⁴ This recognizes that a firm that decides to organize outside its home state is making a dual decision based on the attributes of *both* the home state's law *and* the law of the state of formation. Examining only the attributes of the home state therefore omits important variables bearing on firms' jurisdictional choice.¹⁰⁵

The two state-specific variables that are consistently significant in the regression analysis reported in Table 3A are the series variables and the COC court quality variables. The CGP measure of court influence, which is based on out-of-state citations, is also a significant factor attracting large firms. The regression results show that a state that allows series LLCs and has a high court quality keeps LLCs at home and attracts foreign LLCs to the state. This indicates that LLCs are drawn to states in which they can anticipate high quality litigation outcomes and to states that make important innovations. Delaware, which has the majority of out-of-state formations in this dataset, has the highest index of court quality, based on both the COC court quality and CGP court influence measures, and allows formation of series LLCs.

The fact that court quality and series variables are associated with Delaware raises the question whether the key factor is really formation in Delaware. Table 4 reports regressions based on variables denoting a firm's formation or location in Delaware or both. These Delaware variables yield statistically significant results, while causing the court quality and series variables to become statistically insignificant.¹⁰⁶ This suggests that firms are choosing Delaware, perhaps because of its high court quality and innovation, rather than making a choice among all the states

104. The Bebchuk and Cohen regression analysis of public corporations' choice of incorporation state also only considers the attribute of the home-state statute. See Bebchuk & Cohen, *supra* note 19, at 415–20. But, they test only a single variable, showing that firms choosing to incorporate out of state are moving toward incorporation states with stronger antitakeover provisions. See *id.* at 404–22. We show below, using an analogous single variable, that while LLCs are leaving lax states, these firms are overwhelmingly relocating in lax states, including the primary destination for these firms, Delaware.

105. Including the formation-state variables to fill this gap creates a potential “endogeneity” problem, since the value of the formation-state variable is not given, but rather depends on the LLC's choice of formation state. As a technical matter, an alternative way to address firms' choice of formation state would be to use a conditional logit/discrete-choice model. See generally Daniel McFadden, *Conditional Logit Analysis of Qualitative Choice Behavior*, in *FRONTIERS OF ECONOMETRICS* 105, 107–42 (Paul Zarembka ed., 1974). One study uses a “discrete choice model” to analyze publicly held firms' choice of incorporation state. See Moshe Cohen, *Revisiting Corporate Governance Regulation: Firm Heterogeneity and the Market for Corporate Domicile* 6 (Feb. 17, 2009) (unpublished manuscript) (on file with author), available at http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers/2009spring-Speakers_03-02_Cohen.pdf. Using such a model with the ICARUS data would require that the ICARUS dataset yield a representative sample of the population data of LLCs with respect to these firms' choice of home and formation state. Unfortunately, the ICARUS data as to LLCs that report their formation state does not provide such a sample. For example, comparing the useable ICARUS data to the total firms in the IACA data, see *supra* Table 1, the useable set of LLCs formed in Delaware, the leading state according to the IACA data, is less than 1600, whereas the usable set for Florida, second in total formations based on the IACA data, is over 23,000. Thus, the sample reported in the ICARUS data is not representative of the universe of LLCs.

106. In addition, we also ran the regressions reported in Tables 3A–C on data that excluded LLCs located or formed in Delaware.

based on these factors. The following subsections discuss the results in more detail.

1. *Court Quality*

Court quality's important role in jurisdictional choice by LLCs is one of our most significant findings. One test for court quality is a variable from the influential 2007 Chamber of Commerce State Liability Systems Rankings Study ("COC Study").¹⁰⁷ The validity of this study has been sharply disputed. In particular, Eisenberg notes that the ranking is basically driven by punitive damages and that there are apparent inaccuracies in testing even along this dimension.¹⁰⁸ Even if the punitive damages ranking were accurate, it would not be useful for our purpose of evaluating a state courts' application and interpretation of business association statutes.

We used three alternative tests of court quality to address the problems with the COC study. First, we use Choi, Gulati, and Posner's alternative rankings of state high courts' influence and productivity.¹⁰⁹ The advantage of CGP's rankings over the survey-based COC study is that the former is based on objective statistics collected using a transparent procedure. Specifically, we use CGP's data on out-of-state citations to majority opinions per judge years for common law and commercial cases as a measure of a state court's influence.¹¹⁰ We also use CGP's data on the number of opinions per judge years for common law and commercial cases as a measure of court productivity.¹¹¹ These tests focus on the types of cases that members of business associations would find most relevant to their decision to form in a given state.

A problem with both of the general court quality measures discussed above is that it is not clear how these general quality factors bear on LLCs because states may specialize in areas that may or may not be closely related to LLCs. To address this issue, we also used a second and more specific test based on the number of LLC decisions by a state's courts. Yet even this test may not measure a state's attractiveness to LLCs, since the quantity of reported LLC decisions may not reflect the

107. See U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 51, at 8–11. The study surveyed practicing lawyers in each state and created a total ranking based upon multiple factors, including treatment of tort and contract litigation, enforcement of meaningful venue requirements, treatment of class-action suits, treatment of punitive damages, timeliness of summary judgment and dismissal, discovery, scientific and technical evidence, noneconomic damages, judges' impartiality, judges' competence, judges' predictability, and juries' predictability and fairness. *Id.* at 6. The by-state total ranking is listed in the appendix. *Id.* at 15. Delaware leads the rankings with a ranking of 75.6, while West Virginia (38) and Louisiana (47.3) have the lowest indices. *Id.* at 15 tbl.3A. The average index is 61.7. *Id.* The District of Columbia is not ranked in the study. *Id.*

108. Theodore Eisenberg, *U.S. Chamber of Commerce Liability Survey: Inaccurate, Unfair, and Bad for Business*, 6 J. EMPIRICAL LEGAL STUD. 969, 978–87 (2009).

109. Choi et al., *supra* note 52, at 9–11.

110. *Id.* app. A at 34–35.

111. *Id.* app. A at 32–33.

crucial factor of quality of decisions. Indeed, a large number of poor decisions may be even worse than a smaller body of high-quality decisions because the low-quality decisions may reduce legal predictability.

Because of the questions associated with the court quality measures, we tested the effect on LLC formations of a variable that denotes whether a firm located, formed, or did both, in Delaware. This enables us to determine whether the variable was significant apart from the “Delaware effect” of simply forming in Delaware. This test is discussed further below in Part IV.C.8.

A key aspect of our analysis is that we examine the attributes of *both* LLCs’ home and formation state. The significance of looking at both states is apparent from isolating the COC court quality statistics from the regression analysis. Table 5 shows that the mean home-court quality for firms that chose to form in the home state is only slightly higher than for firms that chose to form out of state (61.5 to 60.8, respectively), based upon LLCs reporting 2006 data.¹¹² But Table 5 also shows that, for firms that formed out of state, the average court quality of the formation state (67.9) is much higher than that of the states they left (60.8). Thus, firms’ formation decisions are driven by the court quality in the formation state, whether or not that state is also the home state. Because Delaware has both the highest COC ranking and a dominant share of out-of-state LLC formations, this result is consistent with the role of Delaware legal institutions in attracting public corporations.¹¹³

Table 5
Average Court Quality
(Based on COC Liability Rankings)

	Obs.	Mean.	S.E.
A. Average Court Quality, Formation State = Home State (Home = 1)	46,110	61.46	0.027
B. Average Home State Court Quality, Out of State Formation (Home = 0)	1868	60.80	0.14
C. Average Formation State Court Quality, Out of State Formation (Home = 0)	1902	67.86	0.180792
Difference B. - A. (t = -4.60)		-.666	.145
Difference C. - A. (t = 35.00)		6.4	.183

In the regression analysis reported in Table 3, we found that the COC home-state court quality variable is positive and statistically signifi-

112. This is consistent with 2006 data reported by Dammann and Schündeln, who find that the home-state court quality variable does not significantly predict whether an LLC forms in its home state. See Dammann & Schündeln, *supra* note 43, at 18 tbl.3.

113. See Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 483 (1987); Romano, *supra* note 16, at 233–43.

cant in all of the reported specifications of variables, and the formation-state court quality variable is negative and statistically significant in all of the reported specifications of variables. The court-quality results are also economically significant. Based on the range of marginal effects reported in Table 3, there is between a 2.8% and 23.6% decrease in the probability of home-state formation for LLCs when the home state has an average court quality (index equal to 61.7) and the formation state is Delaware (with a court quality index of 75.6).¹¹⁴ We also find that the CGP court influence variables are significant in specification (4) of the large LLC (greater than fifty employees) sample reported in Table 3C. The home state CGP influence variable is positive and significant at the .05 level, and the formation state variable is negative and significant at the .10 level. Neither of the CGP productivity variables nor any of the LLC decision variables are significant in any specification.

2. *Innovation: The Series Variable*

The results for the series variable suggest that states' adoptions of these provisions attract LLC formations. The series variables are positive and significant in all of the specifications for the large (greater than fifty employees) and medium (greater than five employees) samples reported in Tables 3B and 3C. The home state variable is negative and significant, whereas the formation state variable is positive and significant. It is not clear whether this indicates firms' preference for innovative states or is a transitory effect that will evaporate as more states pass legislation that enables the use of series LLCs. Moreover, as is discussed in more detail below, it is not clear whether this effect is independent of the choice of Delaware, which was one of the early adopters of this statutory provision. The tie to Delaware is indicated by all-firm regressions reported in Table 3A. These results show that the series variables are significant and have the expected signs when the LLC decision variable is used as a measure of court quality, but not significant in three of the four specifications that include the COC and CGP influence variables, which are highly correlated with Delaware.

3. *Size*

Both the log of employment and the log of revenue are significant factors in LLCs' jurisdictional choice, suggesting that larger firms are more likely to form out of state. The substantive results are similar even when the regression only includes larger firms based on employee size.

114. The 2.8% decrease is derived from the COC formation state coefficient (-0.002) in column (2) of Table 3A (based on the all-LLC sample). The 23.6% decrease is derived from the coefficient (-0.017) on the same variable in column (2) of Table 3C (based on the large (more than fifty employees) LLC sample). The equivalent number from Table 3B (based on the "more than five employees" LLC sample and a coefficient of -0.004) is a 5.6% decrease.

Table 3 shows that the magnitude and statistical significance of the results for the court quality and series variables increase when the sample consists only of large firms.

4. *Flexibility and Debtor Protection*

As shown on Table 3, none of the results for the flexibility or debtor protection variables is statistically significant. These results indicate that LLC competition is not a “race to the bottom” or race for laxity where firms form in states to take advantage of rules allowing members or managers to avoid liability to other members or to creditors. The results for the flexibility variables also could indicate that mandatory LLC provisions are not very restrictive.

5. *Age of Statute*

In theory, older statutes can generate a larger “network” of cases, forms, and legal advice that would make the law in these states more predictable and therefore more attractive. Alternatively, the older LLCs in these states might be locked in by switching costs. Contrary to these hypotheses, however, we find that the number of years since adoption of the home state LLC statute does not significantly affect the decision to form out of the state.

6. *Uniformity Measures*

As discussed in Part II.E, there are theoretical reasons to predict that the degree of uniformity would not significantly affect firms’ decision to form out of state. Consistent with this intuition, none of the uniformity measures included in the regression analysis have a statistically significant effect on LLCs’ jurisdictional choice.

7. *Dammann and Schündeln*

As discussed above in Part II.H, Dammann and Schündeln found results that they characterized as a “flight from laxity”—that is, firms tend not to form at home when their home state statutes are lax, specifically including a lax standard of care. In order to provide a more complete analysis of the effects of LLC jurisdictional choice, we include the variables tested by Dammann and Schündeln in columns (2), (4), and (6) of Tables 3 and 4. Although we use some of the same variables, our test differs in three basic ways from that of Dammann and Schündeln, reflecting distinct theoretical and empirical insights.

First, our regressions use revised codes, listed in the appendix, of several of the LLC statutory variables used by Dammann and Schündeln. In several cases, the Dammann and Schündeln coding of duty of care and

dissolution variables differed from our reading of the statute.¹¹⁵ Dammann and Schündeln identify the dissolution trigger according to the member vote required (e.g., whether unanimous). We take into account whether the statute provides for dissolution by member dissociation. Also, the member dissociation variable does not take account of the fact that default provisions permitting members to dissociate from the LLC but not get paid are functionally equivalent to not permitting dissociation.

Second, we examine the Dammann and Schündeln regressions with the revised coding in the context of our regressions, which include factors such as court quality. Given our theoretical analysis as to which variables are and are not important, when we test the variables together we expect to find changes in results from Dammann and Schündeln. Indeed, as discussed below, we do find some changes in both directions.

Third, as discussed above, we examine the effects of the characteristics of LLCs' formation as well as home states rather than looking at the home state alone as did Dammann and Schündeln. Because this approach better tracks the decisions that LLCs make—that is, whether to move and where to move—we again expect to get different results, and did get differences.

To summarize our results concerning the Dammann and Schündeln variables:

- Several variables that were not significant in Dammann and Schündeln's analysis are also not significant in ours. These include the uniformity test based on ULLCA and the substance of the statutes apart from the "care" variables.
- Some results were consistently significant in our analysis but not in Dammann and Schündeln's, most importantly including home-state court-quality. This difference probably results from the fact that our analysis examines both home- and formation-state court quality. A Dammann and Schündeln variable that denotes whether a firm's home state LLC statute reduces the risk that a failure to observe certain formalities will result in veil-piercing is not significant in their analysis but is negative and significant in some of our regressions. This variable is not significant in any regressions that include the COC court quality or Delaware variables.
- Some significant Dammann and Schündeln results were not significant in our analysis. Specifically, we do not find evidence that LLCs flee lax states. Table 3 reports regressions that include Dammann and Schündeln's "care 3" variable, which equals one if the state has a gross negligence standard or allows firms to opt out (i.e., is "lax"), and zero if the standard of care is tighter than

115. The differences are noted by an asterisk (*) in the Appendix.

gross negligence and does not allow firms to opt out (i.e., is “non-lax”). The formation state laxity variable is not statistically significant in any reported specification.¹¹⁶ Nor are the individual laxity variables significant when tested independently in the regression.¹¹⁷ The dissolution variable, which denotes when state statutes allow dissolution of an LLC with a sub-unanimous vote, is not significant in any specification.

Table 6
Home and Formation State “Care 3” Variable
(Firms that Form Out of State, 2006 Data)

		Formation State		
		0	1	Total
Home State	0	46	164	210
	1	242	1457	1699
	Total	288	1621	1909

A closer look at the raw data illustrates why Dammann and Schündeln’s finding that LLCs are likely to leave lax states does not support the flight-from-laxity theory, as well as the importance of taking into account the attributes of the formation state’s statute. Table 6 shows that, based on 2006 data and for firms with five or more employees, the conditions closest to those reported in Dammann and Schündeln, 1909 firms chose to form outside of their home state. The vast majority of these firms (1699, or 89%) come from lax states (firms where care 3=1). Note, however, that most firms that leave “lax” states (1457, or 86%) go to other lax states. Thus, although the data show that LLCs often *come from* lax states, the most common outcome is a *move to* another lax state. The fact that the vast majority of firms move from lax jurisdictions does not suggest an overall flight from laxity.

The only support for a flight from laxity is that movement from a lax state to a non-lax state occurs more frequently (242) than a move from a non-lax state to a lax state (164). In other words, *when* firms move from one level of laxity to another, they tend to move to less laxity. Dammann and Schündeln’s claim that firms are fleeing laxity rests on only a subset of 406 of the total number of 1909 firms that are moving.¹¹⁸ It is the overall movement that needs to be explained, however, *not* the

116. In an earlier version of this paper, we reported a regression that did not adjust for the low-reporting-rate states. In this regression, the “care 3” variables are significant.

117. In earlier versions of the paper, we reported versions of the regressions reported in Table 3 that included both Dammann and Schündeln’s “care 1” variable, which denotes a state that has a gross negligence or lower standard of care, and their “care 2” variable, which denotes whether a firm can opt out of the default standard of care, in lieu of Dammann and Schündeln’s “care 3” variable. In no specification did we find either the home-state or formation-state variables to be statistically significant.

118. See Dammann & Schündeln, *supra* note 43, at 19.

particular change-in-laxity movement that occurs in a subset of the cases. The fact that most of the movement has nothing to do with laxity undermines rather than supports the flight-from-laxity claim.

In short, neither the substance of the LLC statutes in general, nor a flight from laxity in particular, can explain most LLCs' formation choices after controlling for court quality and the state of origin and destination.

8. *The Delaware Effect*

The relevant factors that emerge from the study are that larger firms have a greater tendency to organize outside their home state and that court quality of both the home and formation state matter. With respect to the latter factor, Delaware dominates both regarding court quality and as a destination state. In other words, the evidence suggests that larger LLCs seek either better courts generally or Delaware in particular. The data are consistent with firms choosing Delaware *law* because disputes under the Delaware statutes are more likely to be heard in Delaware courts than disputes not involving Delaware law,¹¹⁹ and Delaware rates very high in court quality based on either the COC or CGP influence ranking. Firms also may assume that Delaware will seek to maintain its reputation for offering state-of-the-art law irrespective of its specific statutory terms at any particular time.¹²⁰ Other than the relatively new series provisions pioneered by Delaware and a few other states, there is no evidence that any particular statutory provisions have significance independent of court quality.

Our results show that whether Delaware was the formation state is a significant factor in accounting for a firm's decision to form away from its home state. Table 4 reports the same marginal effects for regressions as those reported in columns (1) and (2) in Table 3, except that dummy variables denote whether the LLC was located, formed, or both, in Delaware. The Delaware home and formation state variables are both significant, and the marginal effects are consistent with Delaware retaining and attracting firms. Whether Delaware was the home or formation state was not only significant in isolation, but also affected the results for other variables reported in Table 3. The results for both the COC court quality and series variables, which were statistically significant without the Delaware variables, are no longer significant with these variables included in the regression.¹²¹ In other words, most movement that can be

119. Although any court may hear an issue involving any state's law, courts may decline to hear a case involving another state's law on forum non conveniens grounds. To the extent that Delaware courts seek to, in effect, use formation fees as the price of entry, they can be expected to decline to hear internal governance disputes for non-Delaware business associations.

120. For an analysis of the advantages offered by Delaware's LLC case law, see Ribstein, *supra* note 54, 143–62.

121. Similar results are obtained if the CGP or LLC decision variables are used in lieu of the COC rankings.

explained by court quality and series provisions is movement to Delaware.

V. CONCLUDING REMARKS

Although the empirical and theoretical work so far on jurisdictional competition for business associations has focused on publicly traded corporations, there are equally interesting questions concerning jurisdictional competition for noncorporate and non-publicly-traded entities. We develop a theory of jurisdictional competition for LLCs and identify several factors under that theory that would seem to matter in driving jurisdictional decisions for limited liability companies: firm size, court quality, statutory flexibility, statutory innovation, and debtor protection. Our empirical results suggest that court quality is the most significant factor in allowing states to retain and attract LLCs.

At least as interesting as the factors we find to be important to jurisdictional competition for LLCs are those that we find are *not* important—the factors relating to the substance of the LLC statutes. We tried to identify all of the statutory provisions that might influence firms' choice of formation state. We find that only one (series LLC provisions) matters. Even that variable becomes insignificant once the Delaware variable is added to the regressions. In other words, firms appear to be choosing Delaware rather than series LLC provisions.

Our findings suggest that the significant effort invested by state bars and legislatures in drafting LLC statutes has little payoff in terms of attracting LLCs to the legislating states. The quality of a state's legal environment, particularly including its courts, may be a more important factor in the national competition for LLCs. This is supported by the fact that Delaware, the quality of whose legal environment has been widely acknowledged, dominates the national competition for out-of-state formations that our data measures. State statutory variations may matter not for the national competition, but rather for the competition that each state engages in to keep its locally based LLCs from forming in other states.

This Article is only a first step toward a broader analysis and empirical tests of the forces driving jurisdictional competition beyond publicly traded firms. There are other potential factors that researchers should test. On the demand side, lawyers may influence firms' jurisdictional choice. For example, large firms are more likely to have lawyers in major commercial jurisdictions, such as New York, Illinois, and California, and these lawyers may advise use of local law. Firms also may choose to form in their home state because this affects the law that applies to their business dealings and because of the local legal and economic environment. The choice of physical location, therefore, may reflect choice of law. On the supply side, it is still not clear what drives states to compete for LLCs, or even whether they are doing so. LLCs produce much less in

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franchise or similar fees for states than do large corporations. Closely held firms also are not a major source of business for litigators. The supply side of LLC competition may be driven by transactional lawyers, which suggests that the law governing these firms may be more conducive to efficient contracting than corporations.

In general, these research topics will become more important as unincorporated firms come to occupy a larger part of the business association universe. As this occurs, both the development of systematic data on unincorporated firms and the study of such data should follow.

Appendix: State Level Variables
Flexibility, Innovation, Debtor Protection & Uniformity Variables

State	Fiduciary Waiver	Merger	Contribution	Series	Unlimited Exemption	Restricted Creditor Rights	SP. Charging Order	Third Party Adoptions	Member Adoptions	Tax Adoptions
AL	0	1	0	0	0	0	1	25.24	20.45	22.67
AK	0	0	0	0	0	0	1	27.79	17.45	36.33
AZ	0	1	0	0	0	0	1	26.53	19.06	29.00
AR	1	1	0	0	0	0	0	28.97	19.16	22.67
CA	1	1	0	0	0	0	0	26.84	16.81	28.67
CO	1	0	1	0	0	0	0	26.24	19.61	28.67
CT	1	1	0	0	0	0	0	28.45	20.29	28.00
DE	1	1	1	1	0	1	1	24.03	16.87	36.33
DC	0	1	0	0	0	0	0	27.18	18.32	28.00
FL	0	1	0	0	1	0	0	26.53	18.97	36.33
GA	0	1	0	0	0	0	0	27.37	16.61	30.00
HI	0	1	0	0	0	0	1	26.32	18.45	36.33
ID	0	0	0	0	0	0	1	27.05	20.81	29.00
IL	0	1	0	1	0	0	1	25.34	17.77	36.33
IN	0	0	0	0	0	0	0	28.53	18.00	22.67
IA	0	0	0	1	1	0	0	28.05	18.58	36.33
KS	1	1	0	0	1	0	1	24.13	18.00	36.33
KY	1	1	1	0	0	0	0	25.47	18.68	30.00
LA	0	0	0	0	0	0	0	26.11	16.23	36.33
ME	0	0	0	0	0	0	0	26.82	20.19	22.67
MD	0	0	1	0	0	0	0	24.05	16.19	29.00
MA	1	1	1	0	0	0	0	25.08	17.97	36.33
MI	0	1	0	0	0	0	0	27.89	16.55	19.67
MN	0	0	0	0	0	0	1	26.68	15.58	23.33
MS	0	1	0	0	0	0	0	29.16	20.81	30.00

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Appendix—Continued

State	Fiduciary Waiver	Merger	Contribution	Series	Unlimited Exemption	Restricted Creditor Rights	SP Charging Order	Third Party Adoptions	Member Adoptions	Tax Adoptions
MO	1	0	0	0	0	0	0	26.66	14.68	30.00
MT	0	1	0	0	0	0	1	27.63	20.03	36.33
NE	0	1	0	0	0	0	0	22.58	13.90	21.33
NV	0	1	0	1	0	0	1	21.00	16.23	28.67
NH	0	1	0	0	0	0	0	29.79	21.16	36.33
NJ	1	1	0	0	0	1	1	26.05	20.19	36.33
NM	1	1	0	0	0	0	0	26.05	17.65	22.67
NY	0	1	0	0	0	1	0	28.74	18.32	28.67
NC	0	1	1	0	0	0	0	29.50	19.06	16.00
ND	0	1	0	0	0	0	1	26.21	15.77	23.33
OH	0	1	0	0	0	0	0	25.61	19.26	29.00
OK	0	1	1	1	0	0	1	28.32	21.29	15.67
OR	0	1	0	0	0	0	0	29.50	19.10	28.00
PA	0	1	0	0	0	0	0	24.08	16.16	36.33
RI	0	0	0	0	0	0	0	30.79	18.81	36.33
SC	0	1	0	0	0	0	1	26.71	17.13	29.00
SD	0	0	0	0	1	0	1	24.18	19.39	36.33
TN	0	1	0	1	0	0	1	29.21	19.10	22.00
TX	1	1	1	0	1	1	1	25.55	16.13	23.33
UT	1	1	0	1	0	0	1	25.79	18.06	30.00
VT	0	1	0	0	0	0	1	25.87	19.87	10.33
VA	0	0	1	0	0	1	1	24.74	18.39	28.00
WA	0	0	0	0	0	0	0	27.47	18.42	36.33
WV	0	1	0	0	0	0	1	26.71	19.10	36.33
WI	1	1	0	0	0	0	0	28.68	19.13	29.00
WY	0	0	0	0	0	0	1	17.61	15.32	27.00
<i>(Continued on next page)</i>										

Appendix: Dammann & Schündeln Variables

State	Care1 (* revised)	Care2 (* revised)	Care3 (* revised)	Dissolution	Withdraw (* revised)	Pierce LLC	LLCage	ULLCA
AL	1	1	1	0	1	0	14	1
AK	0	0	0	0	1	0	13	0
AZ	0	0	0	1	0*	0	15	0
AR	1	1	1	0	1	0	14	0
CA	1	1*	1	1	1	1	13	0
CO	1	1	1	0	1	1	17	0
CT	0	1	1	1	1	0	14	0
DE	0	1	1	1	1	0	15	0
DC	0	1	1	0	1	0	13	0
FL	1	1	1	0	1	0	25	0
GA	0	1	1	0	1	1	14	0
HI	1	1	1	1*	0	1	11	1
ID	1	1	1	0	1	0	14	1
IL	1	1	1	1*	1*	1	15	1
IN	1	1	1	0*	1	0	14	0
IA	0	1	1	0	1	1	15	0
KS	0	1	1	1	1	0	17	0
KY	1	1	1	0	1	0	13	0
LA	1	1	1	1	0	0	15	0
ME	0	0	0	0	1	1	13	0
MD	0	0	0	0	1*	0	15	0
MA	0	1	1	0	0	0	12	0
MI	0	1	1	0	1	0	14	0
MN	0	1	1	1	1	0	15	0
MS	0	1	1	0	1	0	13	0

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Appendix—Continued

State	Care1 (* revised)	Care2 (* revised)	Care3 (* revised)	Dissolution	Withdraw (* revised)	Pierce LLC	LLCage	ULLCA
MO	0	1*	1*	0	1*	0	14	1
MT	1	1	1	1*	0	1	14	0
NE	0	0	0	0	1	0	14	0
NV	0	0	0	0	1	0	16	0
NH	1	0	1	1	1	0	14	0
NJ	1	1	1	0	1*	0	14	0
NM	1	1*	1	1	0	0	14	0
NY	0	1	1	1	1	0	13	0
NC	0	1	1	0	1	0	14	0
ND	0	1	1	1	0*	0	14	0
OH	0*	0	0*	0	1	0	13	0
OK	0	1	1	0	1	0	15	0
OR	1	1	1	0	1	1	14	0
PA	0	1	1	0	0	0	13	0
RI	0	1	1	1	1	0	15	0
SC	1	1	1	1*	0	1	13	1
SD	1	1	1	1*	0	1	14	1
TN	0	1	1	1	0*	1	13	0
TX	0	1	1	1	1	0	16	0
UT	1	1*	1	0	1	1	16	0
VT	0	1	1	0	0	0	11	1
VA	0	1	1	0	1	0	16	0
WA	1	1	1	0	1	1	13	0
WV	1	1	1	1*	0	1	15	1
WI	1	1*	1	0	0	0	14	0
WY	0	0	0	0	0*	0	30	0
<i>(Continued on next page)</i>								

Appendix—Court Quality Variables

State	COC Court Quality (2007 Rankings)	CGP Court Reputation (out of state citations per judge-year for common law and commercial cases)	CGP Court Productivity (opinions per judge-year for common law and commercial cases)	LLC decisions (as of 12/31/2006)
AL	50.7	7.900	28.667	6
AK	56	5.611	8.722	0
AZ	66.3	3.467	1.933	0
AR	56.5	5.714	14.476	0
CA	53.5	11.762	7.143	8
CO	65.1	6.565	5.000	5
CT	66.3	6.652	8.652	13
DE	75.6	16.400	4.067	15
DC	N/A	N/A	N/A	0
FL	58.2	4.667	5.333	7
GA	61.2	3.095	13.429	13
HI	56.3	4.111	4.611	1
ID	61.3	4.188	13.375	1
IL	50.8	6.273	6.500	4
IN	68.2	5.933	6.600	5
IA	68.9	6.714	8.286	3
KS	66.7	5.952	6.286	4
KY	60.8	1.682	5.045	0
LA	47.3	2.458	7.625	16
ME	68.9	5.154	13.077	1
MD	61.7	9.318	7.545	1
MA	65.7	5.696	4.9574	1
MI	64.2	4.125	6.917	1
MN	70.6	5.125	6.250	0
MS	46.1	4.517	17.310	4

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Appendix—*Continued*

State	COC Court Quality (2007 Rankings)	CGP Court Reputation (out of state citations per judge-year for common law and commercial cases)	CGP Court Productivity (opinions per judge-year for common law and commercial cases)	LLC decisions (as of 12/31/2006)
MO	60	2.318	4.682	5
MT	57.2	8.095	13.762	2
NE	70	4.783	11.565	0
NV	62	3.222	3.278	0
NH	68.2	3.647	7.059	0
NJ	63.4	7.593	4.481	1
NM	57.5	3.267	2.333	2
NY	65.6	7.955	7.227	37
NC	65.9	2.826	3.652	6
ND	65.4	7.438	10.625	3
OH	63.9	6.190	13.143	10
OK	57.7	3.000	6.393	2
OR	65.7	3.238	3.667	1
PA	60.8	6.000	13.524	0
RI	58.5	4.067	7.467	1
SC	58.1	5.250	5.625	2
SD	67	5.400	10.200	0
TN	68.2	4.813	4.313	3
TX	54.3	6.519	7.815	11
UT	67.7	4.353	12.412	4
VT	62.5	3.800	6.400	0
VA	66.9	7.762	11.238	4
WA	63.7	8.464	6.429	2
WV	38	6.133	6.800	1
WI	67.5	4.952	7.476	2
WY	64.7	4.600	10.533	3

