

**More Evidence of *the Nevada Effect*:
SEC, DOJ, FBI, and IRS Regulatory Enforcement Actions**

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INTRODUCTION

The Nevada effect was introduced by Cataldo, Fuller and Miller (2014; CFM hereafter) upon further examination of the data in Messier, Kozloski and Kochetova-Kozloski's (2010) published work as well as the entire population of 2012 SEC trading suspensions. *The Nevada Effect* is characterized as the over representation of firms who chose to incorporate in Nevada with respect to the number of SEC trading suspensions and underrepresentation of audits on those Nevada corporations by the Big 4 audit firms (who audit nearly 58% of all U.S. publicly traded companies). The current research extends the investigations of *the Nevada Effect*.

A study and examination of the relevant literature stream produces compelling evidence that *there is a market for corporate law*; where states compete for the fees associated with incorporation. The market share leaders and focus of the present study remain Delaware and Nevada. Academic studies have investigated and forensically examined the impact of Delaware and Nevada corporate law (Cary 1974; Winter 1977; Romano 1993; Daines 2001; Abramowicz 2003; Bebchuk and Cohen 2003; Easmunt 2004; Barzuza 2011; and Barzuza and Smith 2012) and Nevada's increased share of the market.

In this article, we extend our body of knowledge on *the Nevada Effect* by examining 17 SEC suspensions made in June 2011 as well as 14 arrests made through a combined Department of Justice (DOJ), Federal Bureau of Investigation (FBI) and Internal Revenue Service (IRS)

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operation; which concluded in 2013. Neither of these investigations was previously examined in CFM (2014). These targeted SEC suspensions and arrests are rare, typically occurring less than once per calendar year, and the 2013 arrests sample provides direct dollar value estimates for funds lost by investors, the data of which is rare and difficult to obtain. Continued analysis of these targeted government actions is critical in understanding the temporal consistency of *the Nevada Effect*, and an important extension to the work started in CFM (2014). Our exploration found, in both instances, that Nevada firms disproportionately represented the targets of these regulatory actions. Since these samples are being externally generated by government agencies they contain no selection bias.

We further our investigation into *the Nevada Effect* by forensically developing and presenting information as well as providing insights into the promotional efforts, practices, and revenues associated with penny stocks¹. Nevada corporations dominate *pump and dump* promotional campaigns. In this scheme managers hire promoters to generate interest in stocks via unsubstantiated claims which entices buyers and inflates the price (the pump). After the stock price is inflated – those with knowledge of the scheme immediately sell their stock positions, typically for huge gains (the dump); thereby driving the price back down which leads to heavy losses for the most recent investors. While this practice is technically illegal, it is the state corporate law that influences or governs the liability against these managers. *The Nevada Effect* contends Nevada state law is, by design, lax in this area and facilitates these behaviors (CFM 2014).

We frame our examination in the context of information asymmetry, market efficiency and agency theory. Examples of favorable stock price reactions and over-reactions are provided

¹ Penny stocks are operationally defined as any stock trading below \$5 per share.

which appear to result from skillfully planned, cleverly crafted and orchestrated timed electronic dissemination of positive information based on both financial fundamentals and non-financial information. We also provide an example of how electronically disseminated non-financial information resulted in a correction to inflated stock prices, very quickly and efficiently; but only after conditions of information asymmetry were corrected and relevant hidden or private information became publicly available.

Akerlof (1970) illustrates that asymmetric information can lead to economic inefficiency, and even destroy an efficient market. Barzuza (2011) explains that Nevada has produced a “shockingly lax” corporate law – which represents a differentiated product – that may create competitive pressures and an environment that would be destructive to an efficient market (and consistent with Akerlof’s concerns).² Nevada is motivated by a desire to generate tax revenue in the form of corporate filing fees; a condition historically and presently dominated by Delaware. In fact Delaware’s revenues are so significant that it has no need for a state sales tax.

The remainder of this article is organized as follows: first, we provide a broad description and integration of relevant, related components of hidden and private information. The former is associated with agency (or contract) theory and the latter is associated with market efficiency (or the efficient market hypothesis). Both fall under the broader study of information economics and information asymmetry. Second, we summarize and describe two separate regulatory actions

² See The Nevada Advantage: Top Reasons to Incorporate in Nevada. Available at <http://nvsos.gov/index.aspx?page=422>, where the Nevada Secretary of State (NVSOS) website lists the reasons and/or advantages associated with incorporation in the state of Nevada as including no (1) corporate income tax, (2) taxes on corporate shares, (3) franchise tax, (4) personal income tax, (5) franchise tax on income, (6) inheritance or gift tax, (7) unitary tax, (8) estate tax, (9) nominal annual fees, (10) Nevada corporations may purchase, hold, sell or transfer shares of its own stock, (11) Nevada corporations may issue stock for capital, services, personal property, or real estate, including leases and options. The directors may determine the value of any of these transactions, and their decision is final, (12) competitive sales and property tax rates, (13) minimal employer payroll tax - 0.7% of gross wages with deductions for employer paid health insurance, (14) Nevada's Business Court, and (15) developed on the Delaware model, the Business Court in Nevada minimizes the time, cost and risks of commercial litigation by: (a) early, comprehensive case management, (b) active judicial participation in settlement, (c) priority for hearing settings to avoid business disruption, and (d) predictability of legal decisions in commercial matters.

from 2011 and 2013. Combined, these actions involved the SEC, DOJ, FBI and IRS. Nevada corporations dominated the targets for these regulatory actions and arrests. Third, we statistically examine the impact of an early 2013 promotional scheme involving a Nevada corporation. The promotional efforts appear to have been sophisticated in that they were skillfully crafted and carefully coordinated at a variety of levels. We provide some fundamental measures and include a comparable Delaware corporation for comparison and context. Finally, we summarize our findings for academics, professionals and regulatory agencies and encourage others to consider alternative approaches, research designs, and continued and expanded investigations into *the Nevada Effect*.

**RELEVANT THEORY:
INFORMATION ASYMMETRY AND HIDDEN AND PRIVATE INFORMATION**

In an economic game, the economic actor or player with private information is the informed player. The economic actor or player with only public information and without private information is the uninformed player.

An environment with hidden information is sometimes characterized as one that facilitates adverse selection (Cabrales and Charness 2008). Information has economic value in that information available to the informed player produces an incentive to use his or her superior information to exploit their information premium. Those facilitating this condition of information asymmetry can extract an information rent (Caillaud and Hermalin 2000).

Adverse selection is pre-contractual. Moral hazard is post-contractual. Just as the former can be linked with hidden information, the latter is more appropriately associated with hidden action. It is, in this fashion, that we illustrate a framework under conditions of information asymmetry that includes both agency theory and market efficiency (see Figure 1).

[Insert Figure 1 here]

From the managerial accounting and contract theory literature streams, principal-agent problems and issues are examined in terms of adverse selection and moral hazard. To the extent that Nevada corporate law facilitates (and/or encourages) information asymmetry, it can attract those seeking these features, and they will be willing to pay a premium for the associated value. Managerial accounting tends to be associated with internal decision-making.

From the financial economics and financial accounting literature streams, the efficient markets hypothesis and market efficiency is framed in terms of the speed or level of information efficiency, where public information is nested within private information, but private information might provide an agent with an *informational advantage*. Financial accounting tends to be associated with external reporting.

Agents (board of directors and/or management) are monitored by professional or self-regulatory (e.g., SOX and PCAOB) and regulatory (e.g., FBI, SEC, and the U.S. Attorney or DOJ) agencies to protect principals (shareholders and other stakeholders). In the case of the CPA and/or auditor, the auditor accepts the role of the monitor/agent and the board of directors/management the role of the principal. It is possible for the CPA/auditor, as an agent of the board of directors/management, to encounter a conflict; where monitoring is not optimized with respect to the stockholder's or principal's interests. For example consulting (profitable) and auditing (less profitable) services performed on the same client were compatible functions. However, post-Enron, WorldCom and SOX these functions were found to be incompatible and not in the best interest of the stockholder/principle.

Likewise, financial analysts, underwriters, and broker-dealers may or may not positively contribute to the monitoring function. Underwriting (profitable) and research conducted by

financial analysts (less profitable) may be substituted by stock promoters, at least in the lower capitalization, small capitalization or micro-cap markets.³

To the extent that Nevada corporate law is designed to favor the agent (management), Nevada generates additional corporate filing fees and/or revenues (information asymmetry-based economics rents), while disproportionately consuming federal regulatory agency resources (*the Nevada Effect*). Asymmetric or hidden information and hidden action, by the better informed agent, can lead to adverse selection (pre-contraction or pre-purchase of a stock) and moral hazard (post-contractual or post-purchase of a stock).

While Ball and Brown (1968) suggest that financial accounting provides information useful to stock market participants, only one eighth of all publicly released information is represented by published financial statements (Lev 1989). Christensen (2010, 295-6) refers to this finding and points out that accounting information is late by construction and asks *why regulate accounting information when most of the information action is going on in the non-regulated regime of other information sources?* As shown below it is in this arena where several Nevada firms have found an opportunity for exploitation and exemplify *the Nevada Effect*.

REGULATORY ENFORCEMENT ACTIONS

This section describes results from two contemporary Securities and Exchange Commission (SEC), Department of Justice (DOJ), Federal Bureau of Investigation (FBI) and Internal Revenues Service (IRS) regulatory enforcement actions occurring in 2011 and 2013, respectively. We provide descriptive measures with a focus on only the state of incorporation and, in particular, on the market share leaders - Delaware and Nevada. Despite the fact that more

³ Micro cap stocks might be said to be *neglected* and referred to as *generic* stocks by traditional financial analysts, which is not an issue in the case of big-cap or *brand name* stocks.

than 50% of the publicly traded firms in the U.S. are incorporated in the state of Delaware, Nevada corporations were involved in the majority of these regulatory enforcement actions.

2011 SEC Suspensions

On June 7, 2011, the SEC suspended trading for 17 Companies, in their proactive effort to combat microcap stock fraud (SEC 2011). Robert Khuzami, Director of the SEC's Division of Enforcement, included auditors in his list of "gatekeepers":

*The SEC's new Microcap Fraud Working Group is targeting the insiders and promoters, as well as the transfer agents, attorneys, **auditors** (emphasis added), broker-dealers, and other "gatekeepers" who flourish in the shadows of this less-than-transparent market.*

"Less-than-transparent" suggests the presence of hidden or private information and could also suggest hidden action (see Figure 1). *The Nevada Effect* is evident in that the firms incorporated in the state of Nevada are disproportionately over-represented and firms incorporated in the state of Delaware are disproportionately under-represented in this SEC suspension of 17 Companies.

Table 1 summarizes the firms and state of incorporation, where 59% were incorporated in the state of Nevada. This compares to 8.3% of total US firms incorporated in the state of Nevada (see Appendices A & B). Therefore, Nevada corporations represented more than six times the proportion one might anticipate and a disproportionately high percentage of these suspensions. Only two of the 10 firms incorporated in the state of Nevada actually operated or headquartered their operations in that state.

[Insert Table 1 here]

Only two of the seventeen suspensions, or less than 12%, were for firms incorporated in the state of Delaware. This compares to 54.3% of total US firms incorporated in the state of Delaware (see Table 1 and Appendices A & B). Therefore, Delaware corporations represented

less than one-quarter of the proportion one might anticipate and a disproportionately low percentage of these suspensions.

2013 DOJ, FBI and IRS Arrests

On February 14, 2013, the DOJ (U.S. Attorney's Office for the Central District of California) released news of the arrest of 14 individuals and identified the entities involved (FBI 2013). The case involved market manipulation and the sale of stock at inflated prices, estimating investor losses in excess of \$30 million (\$11.4 million attributed to Nevada). Therefore, 38% of the illegal proceeds were directly linked to five Nevada corporations (see Table 2).

[Insert Table 2 here]

With only 8.3% of the U.S. firms incorporated in the state of Nevada (see Appendices A & B), and 38% of the illegal proceeds from the DOJ arrests involving Nevada corporations, it is apparent that a disproportionately high amount of scarce, Federal regulatory resources were consumed to identify and make arrests of those associated with these Nevada corporations.

The fiscal year 2012 budget for the Nevada Secretary of State (NVSOS) Securities Division approximated \$25.5 million (NVSOS 2012a). The NVSOS Securities Division is responsible for administering the state's securities law, and their mission is to protect Nevada investors from securities fraud by licensing investment professionals, registering securities offerings, enforcing the state's securities law, and educating the public through community forums, presentations and the distribution of publications.

As of June 30, 2012, the Division's staff totaled 17 full-time employees including seven criminal investigators and four compliance audit investigators. In addition to performing securities investigations, the Division's criminal investigators also conduct corporate filing and election fraud related investigations in their capacity as sworn peace officers. There was no

mention of assistance from NVSOS regulatory authorities in the February 14, 2013, news release.

Recall that the estimate of investor losses exceeded the \$25.5 million amount for the entire NVSOS Securities Division, where estimated investor losses were in excess of \$30 million. We suggest, based on these measures, that the state of Nevada is free-loading – benefitting from the inflow of corporate filing fees or revenues for Nevada’s benefit; while relying on Federal regulators and taxpayers/citizens from all other states to participate in bearing the costs and resources associated with DOJ, FBI, and IRS regulatory actions.

In the next section we provide examples of two firms who were involved in *pump and dump* schemes while we were contemporaneously writing our paper.

EXPLORATORY FINDINGS AND INVESTOR SENTIMENT

In the Internet age, small and micro-cap stock promotion has become big business. An activity that was relegated to cold-calling in years passed can now be swiftly coordinated and executed through websites, email, pop-up ads, and message boards. This activity is dangerous for investors as this promotion is often associated with an illegal scheme known as the *pump and dump*. In this scheme the promoters make misleading or greatly exaggerated claims about the stock when trying to entice buyers. After the stock price has been inflated the perpetrators of the scheme (the promoters themselves or those who hired them) dump their positions in the stock, ideally for huge gains, causing the stock price to fall precipitously – leading to heavy losses for most new investors. While this practice is technically illegal, state corporate law influences the liability managers have in these cases, and as stated above Nevada state law is by design lax in this area.

This leads us to an interesting finding we made in the process of examining and developing measures for the preceding section. While conducting a Google search, we identified a February 20, 2013, electronic article entitled *Seeking Alpha* authored by an organization referring to itself as the Fraud Research Institute (2013). Recall that the second fact pattern in the preceding section of this paper provided descriptive measures from a February 14, 2013, announcement from the DOJ. Therefore, these public releases occurred within a single week

Our attention was directed to an *in-process* stock promotion for Swingplane Ventures, Incorporated (SWVI – a Nevada corporation). The *Seeking Alpha* article named 12 other firms that illustrate associations and support the author’s position – one of negative investor sentiment toward SWVI. We identified the state of incorporation for SWVI and all other firms mentioned in this article. This information is summarized in Table 3.

[Insert Table 3 here]

Eleven of the thirteen firms (85%) were Nevada-based. The high incidence of firms incorporated in the state of Nevada was not discussed in the article. The focus was, instead, on two individuals acting as officers and directors of some of these firms, including one barred from the securities industry.⁴ Apparently, these officers and/or directors were roommates operating out of a condo in Colorado. The stock promoter used by SWVI was *Awesome Penny Stocks*.

Whether coincidental or causally linked, the *Seeking Alpha* article was released on February 20, 2013, and the stock price per share for SWVI dropped, significantly, at the market

⁴ See Securities and Exchange Commission. (2011). *Roundtable on the Execution, Clearance and Settlement of Microcap Securities (Monday, October 17)*. Available at <<http://www.sec.gov/news/otherwebcasts/2011/microcaproundtable101711.shtml>>, where the primary “red flags” drawing the attention of a variety of regulatory agencies include director and officer associates and spouses, particularly those already barred from the industry.

open on February 21, 2013, the following trading day.⁵ We captured this data, which is presented in Figure 2. While not possible to statistically/causally link the release of this electronic *Seeking Alpha* article, scientifically, to the nearly immediate and significant decline in SWVI's stock price, the events are precisely correlated and consistent with Christensen's (2010) hypothesis that accounting information, per se, is not the most significant or relevant information used by investors or stock price reactions. If presumed to be causally linked, the stock price reaction is consistent with the efficient market hypothesis, where previously hidden or private information, once disclosed and made public, reduces the level of information asymmetry.

StockPromoters.com monitors newsletter activity.⁶ Table 4 lists the 10 most promoted penny stocks for the week ended February 24, 2013.

[Insert Figure 2 and Table 4 here]

SWVI ranked second in the top ten of the most promoted penny or micro-cap stocks for the week. We investigated the state of incorporation for each of the top 10 firms. Eight of the top 10 most promoted stocks are incorporated in the state of Nevada.

Upon further investigation, 75 (90%) of the 83 newsletters used to promote SWVI were from (1) *Awesome Penny Stocks*, (2) *Penny Stock Expert*, (3) *PennyStocks.com*, and (4) *Victory Stocks*. The headlines and content are comparable for all four of these electronic newsletters, where the cost for a single newsletter is disclosed as 10,200 BRL or more than \$90,000 for 18 dates/deliveries (i.e., \$5,171 multiplied by 18) by a single promoter.

⁵ It should be noted that two other online articles, favorable mentioning SWVI were published: (1) Eastman, J. (2013). "Why Copper, Why Now?" *The Motley Fool* (February 20); available at <<http://beta.fool.com/johneastman00/2013/02/20/why-copper-why-now/25077/>> & (2) Stocks on Wall Street. (2013). "Copper Rally Continues to Give A Buy Signal For These Two Stocks," *Investing.com* (February 21 06:03AM GMT); available at <<http://www.investing.com/analysis/copper-rally-continues-to-give-a-buy-signal-for-these-two-stocks-156137>>.

⁶ Available at <<http://stockpromoters.com/News-Letters.aspx?symbol=SWVI>>.

We examined the impact of the frequency of these promotions on stock price and volume. As is often the case in these *weak form* tests of market efficiency, a comparable analysis, this time by stock price, did not yield significant results. However, the frequency of these stock promotions and volume produced precisely the results one might anticipate. These results are summarized in Table 5.

[Insert Table 5 here]

Table 5 provides the results from equation [1a]. We used the natural log of volume of shares traded (LnVol) as the dependent variable in our examination of the impact of the eight sources of promotion issued and paid for by SWVI from October 23, 2012, through February 22, 2013.

$$\begin{aligned} \text{LnVol}_i = & \alpha_i + \beta_1 \text{Marketwire}_{1i} + \beta_2 \text{PRNewswire}_{2i} + \beta_3 \text{Accesswire}_{3i} \\ & + \beta_4 \text{CanadaNewswire}_{4i} + \beta_5 \text{AwesomePennyStocks}_{5i} + \beta_6 \text{PennyStockExpert}_{6i} \\ & + \beta_7 \text{PennyStocks.com}_{7i} + \beta_8 \text{VictoryStocks}_{8i} + \varepsilon_i \end{aligned} \quad [1a]$$

Multicollinearity resulted in the elimination of *PennyStocks.com* and *VictoryStocks*.

AwesomePennyStocks contributed little to the regression model, was insignificant, and was also removed. (Recall that we reviewed these three and *PennyStockExpert* for content, and they appeared to contain the same or similar content in their headlines and the body of these promotional electronic newsletters.) The result, after eliminating three of the eight newsletters and relative event date-based dummy variables, was equation [1b], as follows:

$$\begin{aligned} \text{LnVol}_i = & \alpha_i + \beta_1 \text{Marketwire}_{1i} + \beta_2 \text{PRNewswire}_{2i} + \beta_3 \text{Accesswire}_{3i} \\ & + \beta_4 \text{CanadaNewswire}_{4i} + \beta_4 \text{PennyStockExpert}_{4i} + \varepsilon_i \end{aligned} \quad [1b]$$

For equation [1b], all four (presumably) independent public relations and/or promotional releases are statistically significant at the .05 level, and explain nearly 98% of the variability in trading volume for SWVI stock.

In addition to these promotional newsletters, individuals appear to have been retained to *tout* the stock on stock chat message boards. Table 6 provides a summary of posts made by an

alias (*Hooka*) on a variety of the IHUB stock chat message boards. In an effort to approximate the economic incentives for one to engage in this form of promotional engagement, we identified N=27 posts over a 90 minute period. The self-disclosed compensation was \$50, or a bit more than \$65,000 per year, based on a 40 hour week.

[Insert Table 6 here]

Fundamentals for SWVI – A Nevada Corporation

SWVI had zero revenues, less than \$50,000 in cash and cash equivalents, and a negative working capital position.

From the September 30, 2011, Form 10-Q/A:

On September 6, 2011, the Company raised \$35,000 through the issuance of 35,000,000 shares of common stock to unrelated parties.

From the December 31, 2011, Form 10-Q:

We have not generated positive cash flows from operating activities. The primary source of capital has been from the sale of equity securities...

The cost of these shares was \$0.0001 per share. In addition 74.1% of the common shares were sold to an individual acting as the president, secretary, treasurer, chief financial officer, and sole director of SWVI – which is permitted under Nevada corporate law.

During February 2013,⁷ after a series of positive news releases and/or advertisements, SWVI reached a 52-week high of \$1.00 per share. This high represents a 10,000% increase from the cost of \$0.0001 per share. Alternatively, consider that a \$1,000 investment was valued at as much as \$10 million during February 2013, less than 18 months after acquisition.

⁷ It is, sometimes, helpful or insightful to actually trade some small amount of money to examine the liquidity of these stocks. In the case of SWVI, one of the authors purchased some shares on February 8 and 11 and sold these shares on February 12 for a tiny, round-trip profit. Both buy and sell executions appeared to be efficient and there was no evidence of any lack of liquidity or *front-running*.

From the December 31, 2012, Form 10-Q:

(SWVI)...was incorporated in the state of Nevada on June 24, 2010, as a development stage company with the a principal business objective of selling men's and women's golf apparel...(o)n August 22, 2012, the Company went through a change in control and management...(o)n October 15, 2012, the Company entered into an assignment agreement with Mid Americas...whereby Mid Americas has the rights to acquire 75% of certain mining concessions in Chile....

This quote from the 10-Q not only establishes SWVI as a Nevada firm, but also shows a rather abrupt change in business model from a golf apparel company to one dealing in Chilean mining concessions. This puzzling conversion raises some suspicion as to the legitimacy of SWVI's business. This information, though publically available, seemed to have been largely ignored by investors as the stock price soared. As of the end of the third quarter of 2013 (September 30), SWVI was trading at \$0.01 per share.

In the next section we examine a comparable Delaware corporation for comparison and contrast.

Fundamentals for CYIG – A Delaware Corporation

Stock promoters rely on the retention of their subscribers to sell their services. To do this, they remind subscribers of their successes. While aggregate compensation measures were not available for *Awesome Penny Stocks*, in the case of the SWVI promotion (a Nevada corporation), they were available for *TribecaInvestments, Ltd.*, involved in the March 3, 2012, promotion for China YCT International Group, Inc. or CYIG (a Delaware corporation). They pre-empted this promotion with a reminder:

*So far this year we've had some amazing alerts with stocks seeing **gains of +6,122%, +1,039%, & +570%**. Now we've also had some alerts that haven't been*

as impressive, but that is all part of trying (sic) to alert you to companies that present actionable opportunities for you to secure trading profits.

Table 7 provides the self-disclosed promotional revenues reported by *TribecaInvestments, Ltd.*, which we have partitioned into both Nevada and Other corporations. Table 7 reveals that 61% of their revenues originate from the promotion of firms incorporated in the state of Nevada. This again represents a disproportionately large amount relative to the total number of US firms incorporated in Nevada.

[Insert Table 7 here]

CYIG is a comparable company to SWVI, in the sense that they are both micro-cap stocks that hired firms to promote their shares. While the evidence may only be anecdotal, the fundamentals of the Delaware incorporated CYIG are in sharp contrast to those of SWVI. In March 2012 CYIG filed a 10-Q with the SEC that contained unaudited financials with a positive working capital position, positive net assets and equity, and positive net earnings per share.

The opening stock price on the Monday following the weekend promotion for CYIG *gapped up* from \$0.003 per share to \$0.30 per share, hitting a high price per share of \$2.84, or nearly a 95,000% increase in a single trading day. CYIG had an unaudited book value of \$1.86 per share, positive working capital, little or no debt, and favorable earnings per share measures. It was, of course, not possible to purchase the share at the \$0.003 price over the weekend promotion. However, the firm's 10-Q, providing the firm's balance sheet and favorable fundamental measures, were publicly available. It had been filed two weeks prior to the promotional announcement.

As of the end of the third quarter of 2013 (September 30), CYIG was trading at \$0.24 per share – a fraction of the firm's liquidation value. Ultimately the story of CYIG was very similar to that of SWVI, despite the stark contrast in their financial fundamentals. This lends even

further credence to Christensen's (2010) argument regarding the importance of non-fundamental information from unregulated sources. Although no regulatory action has commenced on either company, the classic *pump and dump* schemes of SWVI lend anecdotal support to *the Nevada Effect*.

**SUMMARIZING THE RESULTS OF OUR FORENSIC INVESTIGATIONS:
SEC AND DOJ, FBI AND IRS ENFORCEMENT ACTIONS AND OUR EXTENSIONS**

We use Table 8 to summarize and present the results of our forensic examination of the Nevada effect.

[Insert Table 8 here]

We have examined the June 2011, SEC trading suspensions for 17 corporations (Table 1) and the results from a combined effort conducted by the DOJ, FBI and IRS; which was announced in a February 2013 press release (Table 2). In both cases, Nevada corporations were over-represented and Delaware corporations were either under-represented or not represented. These results support the contemporary persistence of *the Nevada Effect*.

We chronicle the steps taken in our forensic examination, which identified far more dramatic Nevada corporation over-representations, based on publically available information during February and March 2013. The *Seeking Alpha* article (Table 3 and Figure 2), a penny stock monitoring website, *Penny Stock Promotions* (Table 4), and a public disclosure of the source of revenues for a stock promoter, *TribecaInvestments, Inc.* (Table 7), all suggest that Nevada is leading Delaware and other states in attracting effective and profitable stock promoters and promotional efforts (Tables 5 and 6). Figure 3 – developed by Appendices A and B – illustrates the market share increases enjoyed by Nevada, perhaps to Delaware's detriment when focusing on 2008-2011 Compustat data.

Both SWVI (Nevada) and CYIG (Delaware) engaged stock promoters and experienced dramatic stock price increases during late February and early March, 2013. At the end of the 2013 calendar year, SWVI was trading at less than \$0.02 per share (from a 52-week high of \$1.00 per share) and CYIG was trading at \$0.40 per share (from a 52-week high of \$2.84 per share). These mini-cases were not selected randomly. They were selected to illustrate the very significant stock promotional outcomes that can be achieved. In the case of SWVI, a Nevada corporation, the promotional activity appears to represent what stock traders and the SEC characterizes as a *pump and dump*. While promoted, CYIG, a Delaware corporation, does not appear to have been a *pump and dump*. Regulators and academic researchers may find these mini-cases helpful when designing research methodologies to further investigate *the Nevada Effect*.

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Table 1
SEC Trading Suspension for 17 Companies
June 7, 2011

<u>Firm Name</u> ⁸	<u>NV</u>	<u>DE</u>
1-American Pacific Rim Commerce Group is a California corporation based in Florida.	0	0
2-Anywhere MD, Inc. is a Nevada corporation with its principal place of business in <u>California</u> .	1	0
3-Calypto Wireless, Inc. is a Delaware corporation based in Texas.	0	1
4-Cascadia Investments, Inc. is a Nevada corporation based in <u>Washington State</u> .	1	0
5-CytoGenix, Inc. is a Nevada corporation based in <u>Texas</u> .	1	0
6-Emerging Healthcare Solutions, Inc. is a Wyoming corporation based in Texas.	0	0
7-Evolution Solar Corporation is a Colorado corporation based in Arizona.	0	0
8-Global Resource Corporation is a Nevada corporation based in <u>North Carolina</u> .	1	0
9-Go Solar USA, Inc. is a Nevada corporation based in <u>Louisiana</u> .	1	0
10-Kore Nutrition, Inc. is a Nevada corporation based in <u>Nevada</u> .	1	0
11-Laidlaw Energy Group, Inc. is a New York corporation based in New York.	0	0
12-Mind Technologies, Inc. is a Nevada corporation based in <u>California</u> .	1	0
13-Montvale Technologies, Inc. is a New Jersey corporation based in New Jersey.	0	0
14-MSGI Technology Solutions, Inc. (f/k/a MSGI Security Solutions, Inc.) is a Nevada corporation based in <u>New York</u> .	1	0
15-Prime Star Group, Inc. is a Nevada corporation based in <u>Nevada</u> .	1	0
16-Solar Park Initiatives, Inc. is a Nevada corporation based in <u>Florida</u> .	1	0
17-United States Oil & Gas Corporation is a Delaware corporation based in Texas.	<u>0</u>	<u>1</u>
Totals Incorporated in Nevada & Delaware	<u>10</u>	<u>2</u>
Percentage Incorporated in Nevada & Delaware	<u>59%</u>	<u>12%</u>

⁸ The state of operation is underlined, where n=2 of the N=10 of the firms incorporated in the state of Nevada are actually operating or have their principal place of business in the state of Nevada.

Table 2
Jurisdiction or State of Fraudulent Inflated Stock Values
U.S. Attorney’s Office – Central District of California
Illegal Proceeds, Specified by Identifiable Jurisdiction or State
February 14, 2013 Press Release

<u>Firm</u> ⁹	<u>Jurisdiction or State</u> ¹⁰	<u>Illegal Proceeds (millions)</u>
1-FrogAds	NV	\$6.8
2-GenMed	NV	\$2.1
3-Empire Post Media	NV	\$1.0
4-Sport Endurance	NV	\$1.0
5-Biostem	NV	\$0.5
6-Calbridge Capital LLC	NV	unspecified
7-Imobolis, Inc.	NV	unspecified
8-Apache Capital LLC	FL	unspecified
9-Big Dog International LLC	FL	unspecified
10-London Finance Group, Ltd.	unknown	unspecified
11-8 Sounds, Inc.	unknown	unspecified
12-Scripted Consulting Group	unknown	unspecified
13-Taylor Financial, Ltd.	unknown	unspecified
Total Identified as NV Corporations		<u>\$11.4</u>
Total Identified		<u>\$30.0</u>

⁹ The names of firms in the article were imprecise. FrogAds is FrogAds, Incorporated, GenMed is Genmed Holding Corporation, Empire Post Media is Empire Post Media, Incorporated, Sport Endurance is Sport Endurance, Incorporated, and Biostem is Biostem U.S. Corporation, based in Clearwater, Florida.

¹⁰ If Internet searches failed to reveal any information on these firms with respect to state of incorporation, they are listed as “unknown.”

Table 3
Jurisdiction or State of Firms Examined by the *Fraud Research Institute*
Seeking Alpha Article
February 20, 2013

<u>Firm</u>	<u>Jurisdiction or State</u>
1-Swingplane Ventures, Incorporated* ¹¹	NV
2-Tapslide, Incorporated ¹²	NV
3-PaperFree Medical Solutions, Incorporated ¹³	NV
4-TheraBiogen	NV
5-Xpention Genetics, Incorporated ¹⁴	NV
6-HS3 Technologies, Incorporated ¹⁵	NV
7-World Moto, Incorporated*	NV
8-TagLikeMe Corporation*	NV
9-Superior Venture*	NV
10-Amwest Imaging, Incorporated*	NV
11-USA Graphite, Incorporated	NV
12-Kushi Resources ¹⁶	CO
13-Great Wall Builders, Limited*	TX

¹¹ When incorporated on June 24, 2010, Matthew Ryan Diehl was the company's sole Officer and Director.

¹² Matthew Diehl formerly acted as Chief Operating Officer and Director. This stock was suspended by the Securities and Exchange Commission from trading on January 19, 2012, for a lack of current and accurate information.

¹³ Matthew Diehl was formerly employed as the Chief Executive Officer.

¹⁴ Aaron Lamkin, an associate (and roommate) of Matthew Diehl, was barred by the Securities and Exchange Commission on November 16, 2011, and can no longer be associated by a registered broker or dealer, for the unregistered distribution of shares.

¹⁵ Aaron Lamkin, an associate (and roommate) of Matthew Diehl, was barred by the Securities and Exchange Commission on November 16, 2011, and can no longer be associated by a registered broker or dealer, for the unregistered distribution of shares.

¹⁶ Matthew Diehl was a former Officer and Director.

* These firms engaged *Awesome Penny Stocks*, a stock promoter.

Table 4
Most Promoted Penny Stocks
Ticker Symbol, Specified by Identifiable Jurisdiction or State
Week Ending February 22, 2013

8 of the Top 10 are Nevada Corporations

<u>Firm</u>	<u>Jurisdiction</u>	
	<u>or State</u>	<u>Newsletters</u>
1-HVYW	NV	122
2-SWVI	NV	83
3-XCHC	NV	83
4-OPIX	NV	69
5-FUEG	FL	56
6-CNCT	FL	46
7-GRPH	NV	43
8-ACGX	NV	40
9-RARS	NV	40
10-GVIT	NV	39

Table 5
 Results of Equation [1b] from the Examination of Stock Trading Volume
 and the Source and Frequency of News Releases and News Wires for SWVI
 October 23, 2012 through February 22, 2013

Regression Results

<u>Description</u>	<u>N</u>	<u>coefficient</u>	<u>t-statistic</u>	<u>p-value</u>
Intercept		0.9881	2.46	0.016
Marketwire	49	1.5059	2.97	0.004
PRNewswire	14	4.2797	4.57	0.000
CanadaNewswire	1	-7.7160	-2.17	0.033
PennyStockExpert	19	11.1570	9.71	0.000
Overall F-statistic				82.7
Adjusted R-squared				97.8

Pearson Correlation Results¹⁷

	<u>PRNewswire</u>	<u>Accesswire</u>	<u>CanadaNewswire</u>	<u>AwesomePennyStocks</u>	<u>PennyStockExpert</u>	<u>PennyStocks.com</u>	<u>VictoryStocks</u>
Marketwire	0.540	0.369	0.143*	0.654	0.679	0.679	0.679
PRNewswire		0.463	0.416	0.297	0.281	0.281	0.281
Accesswire			-0.022*	0.211	0.201	0.201	0.201
CanadaNewswire				0.210	0.202	0.202	0.202
AwesomePennyStocks					0.966	0.966	0.966
PennyStockExpert						1.000**	1.000**
PennyStocks.com							1.000**

¹⁷ *Not significant at the .10 level. **Perfectly Collinear.

It is not uncommon for these thinly traded micro caps to react favorably to promotional campaigns – in this case, an extraordinarily well-executed one. It is not possible to examine the price per share for this firm, in any meaningful manner, since there are no earnings and trading or selling into these promotionally-developed rallies is sub-optimal. There are no fundamental measures likely to provide any explanatory power. It is for this reason that we focused on volume-based measures and use a volume-based transform. If we replace the natural log of the volume for SWVI with that for the Dow Jones Industrial Average, for example, the same set of independent variables produce an R-squared measure of 0.0% and all independent variables are insignificant at the 30 percent level.

Table 6
SWVI Posts by *Hooka* and on the IHUB Stock Chat Message Board
February 25, 2013

<u>Posts by Hooka</u>	<u>Board</u>	<u>Date/Time</u>
1- SWVI .7251 +9%	Momentum Players	11:03:54 AM
2- SWVI .7251 +9%	Swingplane Ventures Inc (SWVI)	11:03:42 AM
3- SWVI - Copper Rally Continues To Give A	MOMO'S BREAKOUT BOARD	11:02:30 AM
4- Investing.com has new Article about SWVI - http://www.investing.com/analy	STOCKGOODIES PLAYS OF THE WEEK	11:01:30 AM
5- Investing.com has new Article about SWVI - http://www.investing.com/analy	BB's Stock Haven	10:59:58 AM
6- SWVI - Why Copper, Why Now?	Momentum Players	10:58:48 AM
7- SWVI - Why Copper, Why Now?	Penny Stock Millionaire	10:58:21 AM
8- SWVI - 4 Metal Stocks To Buy On	MOMO'S BREAKOUT BOARD	10:57:15 AM
9- SWVI - 4 Metal Stocks To Buy On	.0001 PICKS ONLY	10:56:50 AM
10- SWVI - As it pushes to evaluate the	Swingplane Ventures Inc (SWVI)	10:56:11 AM
11- SWVI - As it pushes to evaluate the	Stock Legends	10:55:51 AM
12- \$SWVI - Company officials admit that production is	BB's Stock Haven	10:55:19 AM
13- \$SWVI - Company officials admit that production is	MOMO'S BREAKOUT BOARD	10:55:08 AM
14- \$SWVI - Trading as a pink sheet stock,	Momentum Players	10:27:28 AM
15- \$SWVI - Demand for copper is falling, but	Money Runners	10:26:51 AM
16- \$SWVI - Demand for copper is falling, but	MOMO'S BREAKOUT BOARD	10:26:37 AM
17- SWVI - This Company Has Copper Mining On	The Hunt for the Next 10 Bagger	10:24:55 AM
18- \$SWVI - Copper is found in many places	STOCKGOODIES PLAYS OF THE WEEK	10:23:52 AM
19- \$SWVI - Copper is found in many places	Swingplane Ventures Inc (SWVI)	10:23:36 AM
20- SWVI - Copper prices have rallied over the	BB's Stock Haven	10:23:04 AM
21- SWVI - Copper prices have rallied over the	MOMO'S BREAKOUT BOARD	10:22:44 AM
22- SWVI..... Copper Rally Continues To Give A Buy	Swingplane Ventures Inc (SWVI)	9:55:34 AM
23- SWVI..... Copper Rally Continues To Give A Buy	STOCKGOODIES PLAYS OF THE WEEK	9:55:04 AM
24- SWVI..... Copper Rally Continues To Give A Buy	BB's Stock Haven	9:36:01 AM
25- Huge Article about SWVI	Swingplane Ventures Inc (SWVI)	9:34:52 AM
26- Huge Article about SWVI	BB's Stock Haven	9:32:29 AM
27- Huge Article about SWVI	MOMO'S BREAKOUT BOARD	9:31:54 AM

Table 7
Self-Reported Promotional Campaign Revenues for *TribecaInvestments, Ltd.*
Nevada (NV) and Other States of Incorporation
10 Month Period through February 2013

	<u>NV</u>	<u>Other</u>
\$40,000 Up to \$40,000 for OREO by a third party, Winning Media. (4/15/2012 - 4/27/2012)	\$40,000	\$0
\$40,000 Up to \$40,000 for AEDC by a third party, Winning Media. (4/24/2012)	\$40,000	\$0
\$40,000 Up to \$40,000 for RACK by a third party, Winning Media. (5/6/2012)	\$40,000	\$0
\$50,000 Up to \$50,000 for PFNI by a third party, Winning Media. (5/8/2012)	\$50,000	\$0
\$40,000 Up to \$40,000 for BRFH by a third party, Winning Media. (5/13/2012)	\$0	\$40,000
\$40,000 Up to \$40,000 for ORYN by a third party, Winning Media. (5/27/2012)	\$40,000	\$0
\$40,000 Up to \$40,000 for LBGO by a third party, Winning Media. (6/17/2012)	\$0	\$40,000
\$50,000 Up to \$50,000 for IMUN by a third party, Winning Media. (7/31/2012)	\$0	\$50,000
\$50,000 Up to \$50,000 for TNIB by a third party, Winning Media. (8/7/2012)	\$0	\$50,000
\$45,000 Up to \$45,000 for FUEG by a third party, Winning Media. (9/4/2012)	\$0	\$45,000
\$42,500 Up to \$42,500 for LBGO by a third party, Winning Media. (9/5/2012)	\$0	\$42,500
\$40,000 Up to \$40,000 for SEFE by a third party, Winning Media. (9/11/2012)	\$40,000	\$0
\$40,000 Up to \$40,000 for ORYN by a third party, Winning Media. (9/16/2012)	\$40,000	\$0
\$40,000 Up to \$40,000 for CHMR by a third party, Winning Media. (9/19/2012)	\$40,000	\$0
\$40,000 Up to \$40,000 for GNGR by a third party, Winning Media. (9/26/2012)	\$0	\$40,000
\$40,000 Up to \$40,000 for LBGO by a third party, Winning Media. (10/01/2012)	\$0	\$40,000
\$40,000 Up to \$40,000 for ORYN by a third party, Winning Media. (10/14/2012)	\$40,000	\$0
\$40,000 Up to \$40,000 for GRST by a third party, Winning Media. (10/18/2012)	\$0	\$40,000
\$35,000 Up to \$35,000 for CUAU by a third party, Winning Media. (10/28/2012)	\$35,000	\$0
\$30,000 Up to \$30,000 for AVXL by a third party, Winning Media. (11/05/2012)	\$30,000	\$0
\$30,000 Up to \$30,000 for FSTC by a third party, Winning Media. (11/13/2012)	\$0	\$30,000
\$25,000 Up to \$25,000 for IMUN by a third party, Winning Media. (11/27/2012)	\$0	\$25,000
\$30,000 Up to \$30,000 for URBF by a third party, Winning Media. (1/13/2013)	\$30,000	\$0
\$60,000 Up to \$60,000 for ZPPB by a third party, Winning Media. (1/22/2013)	\$60,000	\$0
\$60,000 Up to \$60,000 for CWNM by a third party, Winning Media. (1/23/2013)	\$60,000	\$0
\$60,000 Up to \$60,000 for ITNS by a third party, Winning Media. (1/29/2013)	\$60,000	\$0
\$65,000 Up to \$65,000 for HKTU by a third party, Winning Media. (2/3/2013)	\$0	\$65,000
\$60,000 Up to \$60,000 for PMCM by a third party, Winning Media. (2/7/2013)	\$0	\$60,000
\$60,000 Up to \$60,000 for BFLD by a third party, Winning Media. (2/10/2013)	\$60,000	\$0
\$60,000 Up to \$60,000 for RARS by a third party, Winning Media. (2/19/2013)	\$60,000	\$0
\$60,000 Up to \$60,000 for GRPH by a third party, Winning Media. (2/20/2013)	\$60,000	\$0
<u>\$50,000</u> Up to \$50,000 for USTU by a third party, Winning Media. (2/26/2013)	<u>\$50,000</u>	<u>\$0</u>
<u>\$1,442,500</u>	<u>\$875,000</u>	<u>\$567,500</u>

Percent of total revenues

61%

39%

Table 8
Nevada (NV) versus Delaware (DE) Percentage Comparisons
Selected Summary, Back-Tested, and Extended Measures

	<u>NV</u>	<u>DE</u>	<u>Year</u>	<u>Description</u>
<u>Regulatory Enforcements</u>				
Table 1	59%	12%	2011	June 7 SEC Trading Suspensions for 17 Corporations
Table 2	54%	0%	2013	February 14 DOJ-FBI-IRS Press Release
<u>Supplemental</u>				
Table 3 & Figure 2	85%	0%	2013	February 20 <i>Seeking Alpha</i> Article
Table 4	80%	0%	2013	February 22 Penny Stock Promotions
Table 7	61%	0%	2013	March 3 Promotional Revenues self-reported by <i>TribecaInvestments, Ltd.</i>
<u>1993 through 2008</u>				
Appendix A	5%	54%		Mean measures for Nevada and Delaware
<u>2008 through 2011 Trend</u>				
Figure 3	7.0%	56.0%	2008	Market Share from Compustat
Figure 3	7.4%	55.6%	2009	Market Share from Compustat
Figure 3	8.1%	55.0%	2010	Market Share from Compustat
Figure 3 & Appendix A & B	8.3%	54.3%	2011	Market Share from Compustat

Figure 1
 Information Asymmetry:
 Mapping Agency Theory to Market Efficiency
 As adapted from Cataldo

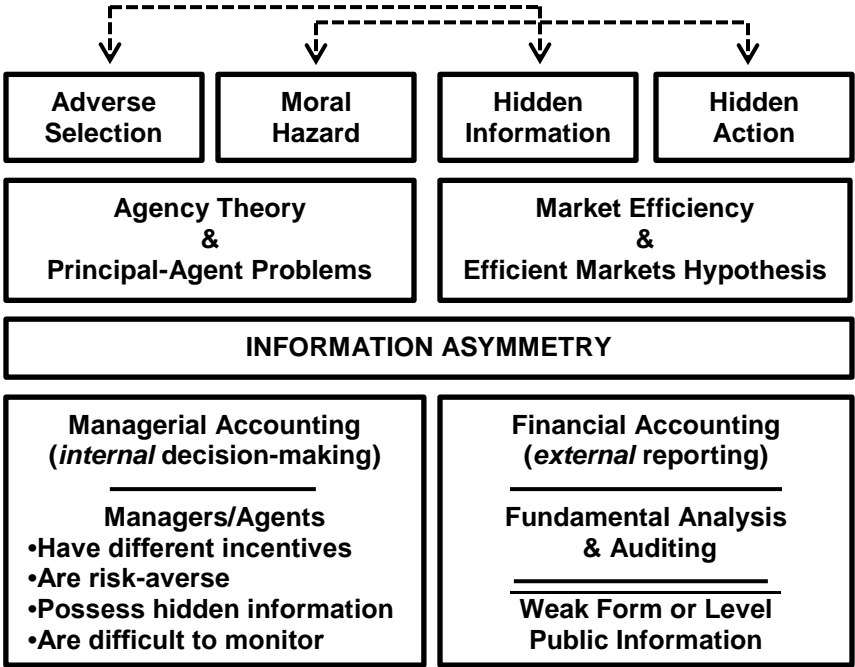


Figure 2
Fraud Research Institute – Seeking Alpha Article - February 20, 2013
January 24 through February 21, 2013
Daily Stock Price Trading Ranges for SWVI

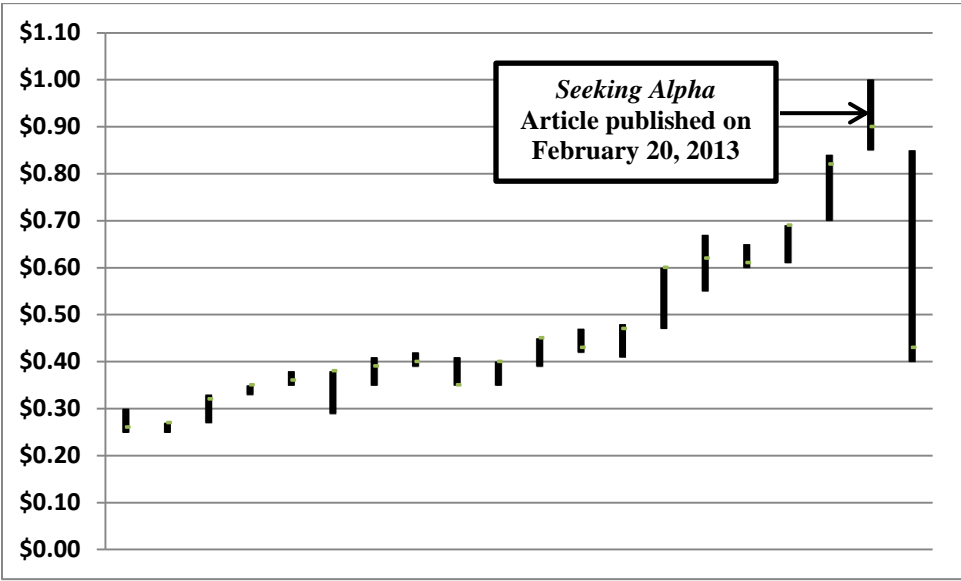
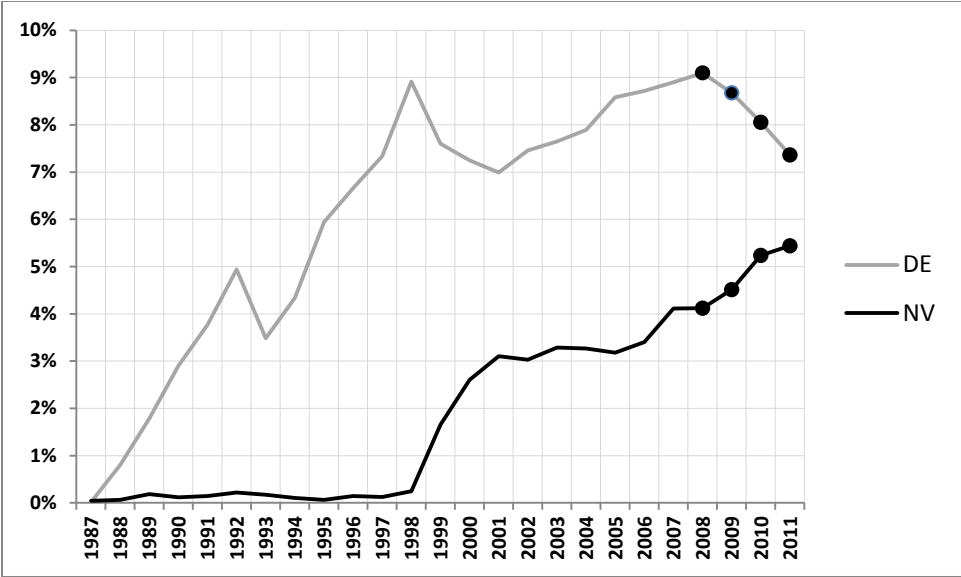


Figure 3
Delaware and Nevada Market Share Trend – Percentage Increase
Compustat - 1987 through 2011 (1987 base year)
Developed from Appendix A & B



Appendix A
Nevada (NV), Delaware (DE) and Combined Market Share
Compustat

<u>Year</u>	<u>NV</u>	<u>DE</u>	<u>NV & DE</u>
1987	2.9%	46.9%	49.9%
1988	3.0%	47.7%	50.7%
1989	3.1%	48.7%	51.8%
1990	3.0%	49.8%	52.8%
1991	3.0%	50.7%	53.7%
1992	3.1%	51.8%	55.0%
1993	3.1%	50.4%	53.5%
1994	3.0%	51.2%	54.2%
1995	3.0%	52.8%	55.8%
1996	3.0%	53.6%	56.6%
1997	3.0%	54.2%	57.3%
1998	3.1%	55.8%	59.0%
1999	4.6%	54.5%	59.1%
2000	5.5%	54.2%	59.7%
2001	6.0%	53.9%	59.9%
2002	5.9%	54.4%	60.3%
2003	6.2%	54.5%	60.7%
2004	6.2%	54.8%	61.0%
2005	6.1%	55.5%	61.6%
2006	6.3%	55.6%	61.9%
2007	7.0%	55.8%	62.8%
2008	7.0%	56.0%	63.0%
2009	7.4%	55.6%	63.0%
2010	8.1%	55.0%	63.1%
2011	8.3%	54.3%	62.6%

Appendix B
Corporations in the Compustat Database by State or Jurisdiction for Fiscal Year 2011
(including Foreign countries and U.S. Only)

	State of Incorporation (including Foreign)	Number of Firms	Percent of Total		State of Incorporation (U.S. Only)	Number of Firms	Percent of Total
1	AK	4	0.06%	1	AK	4	0.07%
2	AL	7	0.11%	2	AL	7	0.13%
3	AR	8	0.12%	3	AR	8	0.15%
4	AZ	10	0.15%	4	AZ	10	0.19%
5	CA	121	1.87%	5	CA	121	2.24%
6	CO	61	0.94%	6	CO	61	1.13%
7	CT	21	0.32%	7	CT	21	0.39%
8	DC	7	0.11%	-			
9	DE	2,928	45.21%	8	DE	2,928	54.26%
10	Foreign	1,081	16.69%	-			
11	FL	109	1.68%	9	FL	109	2.02%
12	GA	48	0.74%	10	GA	48	0.89%
13	GU	1	0.02%	-			
14	HI	6	0.09%	11	HI	6	0.11%
15	IA	18	0.28%	12	IA	18	0.33%
16	ID	7	0.11%	13	ID	7	0.13%
17	IL	23	0.36%	14	IL	23	0.43%
18	IN	60	0.93%	15	IN	60	1.11%
19	KS	10	0.15%	16	KS	10	0.19%
20	KY	18	0.28%	17	KY	18	0.33%
21	LA	19	0.29%	18	LA	19	0.35%
22	MA	57	0.88%	19	MA	57	1.06%
23	MD	283	4.37%	20	MD	283	5.24%
24	ME	7	0.11%	21	ME	7	0.13%
25	MI	52	0.80%	22	MI	52	0.96%
26	MN	87	1.34%	23	MN	87	1.61%
27	MO	38	0.59%	24	MO	38	0.70%
28	MS	12	0.19%	25	MS	12	0.22%
29	MT	6	0.09%	26	MT	6	0.11%
30	NC	41	0.63%	27	NC	41	0.76%
31	ND	4	0.06%	28	ND	4	0.07%
32	NE	6	0.09%	29	NE	6	0.11%
33	NH	2	0.03%	30	NH	2	0.04%

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34	NJ	61	0.94%	31	NJ	61	1.13%
35	NM	3	0.05%	32	NM	3	0.06%
36	<i>NV</i>	450	6.95%	33	<i>NV</i>	450	8.34%
37	NY	136	2.10%	34	NY	136	2.52%
38	OH	114	1.76%	35	OH	114	2.11%
39	OK	19	0.29%	36	OK	19	0.35%
40	OR	36	0.56%	37	OR	36	0.67%
41	PA	121	1.87%	38	PA	121	2.24%
42	PR	4	0.06%	-			
43	RI	6	0.09%	39	RI	6	0.11%
44	SC	18	0.28%	40	SC	18	0.33%
45	SD	4	0.06%	41	SD	4	0.07%
46	TN	24	0.37%	42	TN	24	0.44%
47	TX	93	1.44%	43	TX	93	1.72%
48	UT	27	0.42%	44	UT	27	0.50%
49	VA	81	1.25%	45	VA	81	1.50%
50	VT	1	0.02%	46	VT	1	0.02%
51	WA	53	0.82%	47	WA	53	0.98%
52	WI	52	0.80%	48	WI	52	0.96%
53	WV	7	0.11%	49	WV	7	0.13%
54	WY	<u>5</u>	<u>0.08%</u>	50	WY	<u>5</u>	<u>0.09%</u>
	Total	<u>6,477</u>	<u>100.00%</u>		Total	<u>5,396</u>	<u>100.00%</u>