THE MARKET VALUE OF PARTISAN BALANCE

Brian D. Feinstein* & Daniel J. Hemel†
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For the past century, Delaware's Constitution has provided that no more than a bare majority of judges on the state's courts may hail from the same political party. Some scholars and jurists theorize that Delaware's commitment to a politically balanced judiciary increases the state's attractiveness to out-of-state corporations and adds value to Delaware-chartered firms. These claims echo a larger literature in law and the social sciences positing that ideological diversity improves decisional quality. Recently, a series of federal court decisions in the case of Adams v. Carney *put these claims to the test. In December 2017, a federal district court held that Delaware's partisan balance regime violates the First Amendment's freedom-of-association guarantee because it discriminates among judicial candidates based on party affiliation. In December 2020, the U.S. Supreme Court vacated the lower court decision and restored Delaware's scheme. The* Adams *litigation—which generated a series of exogenous shocks to Delaware's legal regime—enables assessment of the value of partisan balance. If a politically balanced judiciary truly does add value to Delaware-chartered corporations, then the share prices of Delaware firms should have declined in the wake of the December 2017 district court decision and should have risen in response to the December 2020 Supreme Court ruling.*

This study is the first to examine how equity markets responded to key decisions in the Adams *litigation. Applying a range of model specifications, we find that Delaware firms experienced negative abnormal returns on the date of the district court decision and positive abnormal returns on the date of the Supreme Court's ruling. These findings—supplemented by results from other key dates in the* Adams *litigation—are broadly consistent with the theory that a politically balanced judiciary adds value to Delaware-chartered firms.*

We conclude by considering the implications of our results for two larger debates in legal scholarship: the debate over partisan balance requirements for federal courts and the debate over Delaware's dominance in the interstate market for corporate charters. As for the former, our results provide the first revealed-preference evidence that relevant stakeholders assign positive value to partisan balance requirements for adjudicative bodies—a finding that potentially bolsters the arguments of scholars and politicians who want to extend similar requirements to U.S. Supreme Court justices. As for the latter, our results suggest that Delaware's commitment to a politically balanced judiciary accounts for a nontrivial component of the so-called "Delaware effect"—the share-price boost observed in some studies for firms that reincorporate in the state. In the interjurisdictional market for corporate charters, Delaware's judicial partisan balance requirements give the state a potentially significant competitive advantage vis-à-vis rivals that lack similar provisions.

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* Assistant Professor of Legal Studies & Business Ethics, the Wharton School of the University of Pennsylvania.

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TABLE OF CONTENTS

INTRODUCTION 3

I. BACKGROUND 6
  A. Partisan Balance Requirements 6
    1. The Evolution of Partisan Balance Requirements at the Federal and State Level 6
    2. Potential Benefits and Costs of Partisan Balance 7
    3. Empirical Literature on Partisan Balance Requirements 9
  B. Delaware's Dominance in the Market for Corporate Charters 12
  C. The *Adams* Litigation 15

II. RESEARCH DESIGN 19
  A. Hypotheses 19
    1. Major Events 19
    2. Other Events 21
  B. Data 23
  C. Methods 24
    1. Event Study Analysis 25
    2. Event Day Regression Models 26
    3. Pooled Regression Models 27

II. ANALYSIS 27
  A. Event Study Analysis 27
    1. District Court Decision 27
    2. Supreme Court Decision 29
    3. Other Events 31
  B. Event Day Regression Models 33
  C. Pooled Multi-Day Regression Models 35

III. IMPLICATIONS 37
  A. Interpreting the Results 37
  B. Implications for Partisan Balance Requirements 38
  C. Implications for Delaware's Dominance 40

CONCLUSION 43

APPENDICES 44
  Appendix A: Abnormal Returns by Firm Size 44
  Appendix B: Additional Tests 47

REFERENCES 51

INTRODUCTION

Partisan balance requirements are embedded into the design of many institutions of American public law. Dozens of federal agencies—including the Federal Trade Commission and the Securities and Exchange Commission—are subject to one type of partisan balance requirement: a bare-majority limitation, which states that no more than a simple majority of members may come from the same political party. Similar bare-majority limitations apply to one Article III court (the U.S. Court of International Trade) and one other federal court (the Court of Appeals for Veterans Claims).

Partisan balance requirements are less prevalent at the state level, where effective one-party control over all branches of government is more common. However, New Jersey has long followed an informal norm of partisan balance in appointments to its supreme court—a practice that dates to the court's founding in 1947. The Marion Superior Court in Indiana's most populous county elected judges according to a statutory scheme that virtually assured partisan balance from 1975 until 2015. And Delaware—alone among U.S. states—has enshrined a judicial partisan balance regime into its constitution.

For most of the post-World War II period, Delaware courts have been subject to two different partisan balance requirements: a bare-majority limitation and an other-major-party reservation. The bare-majority limitation—like the bare-majority limitations for many federal agencies and two federal courts—capped the number of judges from any one party at a simple majority of the court's membership. The other-major-party reservation required that all remaining members hail from the "other major political party" (i.e., from the Republican Party when a bare majority are Democrats). However, in December 2017, a federal district court ruled in *Adams v. Carney* that Delaware's bare-majority limitation and its other-major-party reservation violate the federal Constitution's freedom-of-association guarantee. Three years later, the U.S. Supreme Court effectively erased the district court's decision when it held that the plaintiff in the case lacked standing to challenge the state's partisan balance regime. The long-running litigation ended in January 2023 with a consent judgment that allowed the state to maintain its bare-majority limitation but compelled it to drop the other-major-party reservation.

Importantly, Delaware is an outlier not only insofar as it has imposed formal partisan balance requirements on its judiciary but also insofar as it dominates the market for corporate charters. Moreover, several authors have argued that these two facts are related: that Delaware's success in attracting incorporations stems at least in part from its constitutional commitment to a politically balanced judiciary (Veasey with Di Guglielmo 2005; Holland 2009; Eldar and Rauterberg 2023). If these authors are correct—if part of the value of a Delaware charter is attributable to the state's constitutional partisan balance regime—then we might expect the share prices of Delaware-incorporated firms to fall after the initial invalidation of the state's partisan balance rules and to rise after those rules were restored by the U.S. Supreme Court.

This study is the first to examine stock market responses to the sequence of rulings in *Adams*. Market movements during the *Adams* litigation can yield insights for two separate

scholarly debates. First, market reactions to the invalidation and partial restoration of Delaware's partisan balance requirements can inform the debate in U.S. public law regarding the desirability of partisan balance for courts and other institutions. Epps and Sitaraman (2019) suggest that Congress should extend partisan balance requirements to the selection of Supreme Court justices—an idea that then-candidate Pete Buttigieg embraced during his bid for the 2020 Democratic presidential nomination (Lederman 2019). Other scholars, including Sachs (2019) and Doerfler and Moyn (2021), have questioned the value of a high-court partisan balance regime. Stock price responses to *Adams* can shed light on the value that one relevant constituency—shareholders of public companies—assigns to partisan balance requirements in a judicial context.

Second, stock price responses to *Adams* bear potentially important implications for a central question in corporate law: why is Delaware so dominant in the market for corporate charters? As noted, one explanation for Delaware's dominance focuses on the state's constitutional commitment to a politically balanced judiciary. Other explanations emphasize Delaware's small size, its constitutional supermajority requirement for legislative changes to state corporate law, its rich body of precedent, and the "network effects" that arise once a critical mass of firms has flocked to a single jurisdiction (e.g., Romano 1985; Easterbrook and Fischel 1991; Romano 1993; Klausner 1995; Romano 2017; Sanga 2020). If we see a significant drop in the share prices of Delaware-incorporated firms following the initial district court decision striking down the state's partisan balance requirements and a significant rebound after the Supreme Court brought the state's partisan balance regime back to life, then we might conclude that partisan balance requirements play a meaningful role in the story of Delaware's dominance. If, by contrast, the market reactions to those decisions are muted, then we might ascribe more weight to alternative explanations for Delaware's success.

We focus our study on public companies listed on the New York Stock Exchange (NYSE) and NASDAQ, comparing the performance of Delaware-incorporated firms and firms incorporated elsewhere in the United States. Our main analysis zeroes in on the one-day window following the two discrete changes to the legal status of Delaware's partisan balance requirements during the *Adams* litigation: the December 2017 district court decision that invalidated the state's partisan balance regime in toto and the December 2020 Supreme Court ruling that effectively wiped the district court's decision from the books. We also examine market reactions to several other events in the *Adams* litigation, including the affirmance of the district court's ruling by the U.S. Court of Appeals for the Third Circuit, the Third Circuit's denial of rehearing *en banc*, the U.S. Supreme Court's decision to hear the case, the Supreme Court oral argument, and the ultimate consent judgment that preserved Delaware's bare-majority limitation but set aside the other-major-party reservation.

Our results offer qualified support for the view that Delaware's constitutional commitment to a politically balanced judiciary adds value to Delaware-incorporated firms. Across a variety of model specifications, we find that average abnormal returns to Delaware firms were negative in the aftermath of the initial district court decision invalidating the state's partisan balance requirements and positive in the wake of the Supreme Court ruling that restored the state's regime. Our estimates are statistically significant in all but one model specification, though effect sizes are

relatively modest. For example, employing the widely used Fama-French three-factor model, we estimate a negative abnormal return for Delaware firms of approximately 0.3 percentage points following the district court's invalidation of the state's partisan balance regime and a positive abnormal return of approximately 0.3 percentage points after the Supreme Court's ruling. When we extend our analysis to other key dates in the *Adams* litigation, we find a pattern of abnormal returns that is broadly—though not entirely—consistent with the theory that investors value the partisan balance requirements embedded in Delaware law.

Our results thus contribute to—but do not definitively resolve—the twin debates over partisan balance requirements and Delaware's dominance. First, our findings supply the first evidentiary basis for the claim that relevant stakeholders perceive a politically balanced judiciary to be beneficial, though our conclusions are necessarily limited to only one set of stakeholders (investors) and only one jurisdiction's courts. Second, our findings provide qualified support for the theory—first developed by Romano (1985)—that unique features of Delaware's legal landscape increase the market value of Delaware-incorporated firms. Previous event studies have found that publicly traded firms experience positive abnormal returns immediately after announcing their decision to reincorporate in Delaware, but since reincorporation choices are endogenous to other aspects of corporate strategy, those studies cannot distinguish the causal effect of Delaware corporate law from other confounding factors. Our analysis overcomes the endogeneity problem by identifying a series of exogeneous shocks to Delaware's legal system—shocks that cannot be attributed to any change in corporate strategy. And our approach further allows us to isolate the effect of one specific feature of Delaware law—the state's constitutional commitment to a politically balanced judiciary—on the market value of Delaware firms. Our results are especially timely in the wake of a June 2024 vote by shareholders of the electric carmaker Tesla to change that company's state of incorporation from Delaware to Texas, which recently enacted legislation ambitiously aimed at matching Delaware's judicial expertise in commercial matters. Our findings suggest that notwithstanding Tesla's exit, investors in other firms do value Delaware charters—and, in particular, they value Delaware's constitutional commitment to a politically balanced judiciary, a feature of Delaware law that no other state has yet replicated.

This manuscript proceeds in four sections. Section I situates Delaware courts in a larger landscape of government institutions with partisan balance requirements, introduces theoretical and empirical scholarship concerning the effects of these provisions, and explains how partisan balance requirements may contribute to Delaware's preeminent position in the market for corporate charters. The section then introduces *Adams v. Carney*, a winding case in which federal courts delivered several exogenous shocks to the status of Delaware courts' partisan balance requirements.

Section II explains how we leverage these exogenous events in *Adams* to assess the market value of partisan balance. Section III presents our results. In brief, we find that the federal district court's invalidation of Delaware's partisan balance requirements is associated with declines in the value of Delaware-incorporated firms in most models and that the Supreme Court's vacatur of this decision is associated with increases in value. Finally, Section IV considers implications of these

results for partisan balance requirements and for Delaware's dominance in the market for corporate charters.

I. BACKGROUND

A. Partisan Balance Requirements

1. The Evolution of Partisan Balance Requirements at the Federal and State Level

The long history of partisan balance requirements in the United States stretches at least as far back as 1882, when Congress created the five-member Utah Commission to supervise elections in the Utah Territory and mandated that no more than three of the commissioners could be members of the same political party (Krotoszynski, Hodge, and Wintermyer 2015, p. 964). In the subsequent 140-plus years, Congress has established more than 50 multimember bodies subject to statutory partisan balance requirements, including one Article III court (the Court of International Trade), one other court (the Court of Appeals for Veterans Claims), and dozens of agencies with adjudicative functions (Feinstein and Hemel 2020, p. 2). These requirements typically take the form of a bare-majority limitation, which states that no more than a bare majority of commissioners or judges may be members of the same party. For bodies with an even number of members such as the six-member Federal Elections Commission, the statutory partisan balance requirement provides that no more than half of the members may share a party affiliation.

Partisan balance requirements for Delaware's judiciary date back to the state's 1897 constitution, which provided for five "law judges"—a chief justice and four associate judges—along with a chancellor who would hear cases arising in equity. The 1897 constitution further provided that "no more than three of the said five law judges, in office at the same time, shall have been appointed from the same political party." Delegates to the convention that produced the 1897 constitution anticipated that political diversity among state law judges would "bring about a fuller and freer discussion" of matters before the judiciary and would boost public confidence in the state's courts.[1]

In 1951, Delaware amended its state constitution to establish a new three-justice supreme court—reportedly in response to concerns that the lack of a separate supreme court could undermine its attractiveness to out-of-state corporations (Friedlander 2016, p. 1150 n.55). The 1951 amendments continued forward the requirement applicable to law judges under the 1897 constitution that no more than a bare majority could be members of the same political party. The 1951 amendments further provided that the remaining justice must be a member of the "other major political party"—possibly the first example of an other-major-party reservation in American public law. According to one account, lawmakers added the other-major-party reservation to assuage concerns among Republicans in the closely divided legislature that the Democratic governor would otherwise fill the remaining seat on the state supreme court with a nominal independent (Friedlander 2016, p. 1150). Delaware also extended both the bare-majority limitation

[1] Joint Appendix 110, 209, Carney v. Adams, No. 19-309 (U.S. Jan. 21, 2020).

and the other-major-party reservation to members of its chancery court and superior court, and it preserved these provisions when it changed other features of the state judiciary (such as expanding the size of the supreme court from three to five in 1978).

Delaware's constitutional partisan balance regime appears to be one-of-a-kind among U.S. state courts. For four decades, Indiana maintained a statutory scheme for judicial elections to the Superior Court in Marion County—the state's most populous county and the home of the capital city of Indianapolis—that effectively guaranteed an even split between Republicans and Democrats by preventing either party from nominating candidates for more than half of available seats. However, the U.S. Court of Appeals for the Seventh Circuit held in 2015 that the scheme was an unconstitutional burden on the right of voters to cast ballots for the judges of their choice. At part of that decision, the Seventh Circuit observed that the Marion County approach "appears to be unique within the United States, as neither the parties nor the court have been able to find an election system quite like it."[2] New Jersey has long followed a norm that no more than four of its seven supreme court justices may be members of one party—with the remaining three seats reserved for members of the other major party—but the New Jersey norm is an unwritten rule rather than a constitutional command (Wefing 1998, pp. 715-716; Clifford et al. 2010, p. 2).

2. Potential Benefits and Costs of Partisan Balance

Proponents of partisan balance requirements offer three main arguments in favor of those provisions. First, partisan balance typically exerts a moderating effect on policy outcomes. In the U.S. context, where Democrats are generally more liberal than Republicans, the median voter on a multimember body subject to a partisan balance requirement tends to be either the most conservative Democrat or the most liberal Republican—a narrower range of ideological variation than when partisan presidents and governors can appoint an unlimited number of co-partisans to commissions and courts. Furthermore, several empirical studies of judicial behavior find that partisan diversity exerts a depolarizing effect on individual judges' votes. Miles and Sunstein (2006) focus on the federal circuit courts—where judges typically hear cases on three-member panels—and use the party of the appointing president as a proxy for a judge's partisan affiliation. They find that individual judges tend to cast fewer ideologically stereotypical votes on mixed panels than on single-party panels. For example, a Democratic-appointed judge is less likely to side with labor in a labor-management dispute when she sits on a panel with at least one Republican-appointed judge than when she sits on a panel with two other Democratic appointees. Several other studies document similar "panel effects" across various issue areas; having a diverse group of judges on a three-judge panel appears to make individual judges less ideological in their voting patterns (e.g., Sunstein, Schkade, Ellman, and Sawicki 2006; Cox and Miles 2008; Fischman 2013).

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[2] Common Cause Indiana v. Individual Members of the Indiana Election Commission, 800 F.3d 913, 914 (7th Cir. 2015).

Assuming that partisan balance exerts a moderating effect on policy outcomes, proponents of partisan balance requirements still must explain why moderation is a benefit. One possible answer is that moderation promotes policy stability.[3] Several studies find that firms are less likely to make long-term investments when the policy environment is unstable (e.g., Julio and Yook 2012; Fabrizio 2013; Gulen and Ion 2016). Note, though, that the effect of partisan balance on policy stability is contingent upon context. The pro-stability argument for partisan balance requirements is strongest at the federal level, where control of the presidency and Congress routinely change hands. By contrast, in Delaware—which was once a closely divided state along party lines but where Democrats have won every gubernatorial election since 1992 and now hold every statewide office—the elimination of judicial partisan balance requirements might result in more liberal but still quite stable outcomes. Indeed, for cases before the Delaware chancery court (which assigns one judge to each case), partisan balance arguably leads to *greater* uncertainty and instability because it results in wider judge-to-judge ideological variation. If instead all members of the Delaware chancery court were uniformly liberal Democrats, then case-specific uncertainty might be lower than it is today.

Moderation also may be advantageous from the perspective of interest groups that disfavor particular extremes. For example, in the Delaware context, moderation may benefit corporate managers who understand that the alternative to partisan balance requirements—given the Democratic Party's dominance in Delaware politics—is a much more liberal judiciary. From corporate management's perspective, partisan balance is plausibly beneficial because it pushes outcomes to the right of where they would otherwise fall. Put another way, partisan balance is not ideologically neutral, and some interest groups may value partisan balance not because they view moderation or stability as an intrinsic good but because partisan balance redounds to their advantage in a specific setting.

A second argument sometimes advanced by supporters of partisan balance requirements is that ideological diversity improves decision quality. For example, Cross (2007, p. 155) suggests that judges may arrive at a "better understanding of the law" when they are exposed to the perspectives of colleagues with different ideological priors. Similarly, Sunstein (2000)—drawing from the social psychology literature (e.g., Brown 1986; Isenberg 1986)—posits that members of ideologically homogeneous groups may encounter "limited argument pools" and thus may not be forced to confront or respond to strong arguments that cut against their own ideological preferences. The decision-quality effect is difficult to distinguish observationally from the moderation effect: do liberals and conservatives on multimember bodies move to the middle because they come to understand the centrist position as "better" or because they want to avoid conflict with colleagues and therefore seek to strike a compromise? Yet conceptually, the two effects are distinct insofar as the "better" decision—along whatever dimensions such decisions are judged—may not always correspond to the more moderate position.

[3] Indiana sought to justify its partisan balance regime for the Marion Superior Court on similar grounds: as the state told the Seventh Circuit, the limit on the number of judges from any party "ensures stability on the court by removing the possibility that one party could sweep the election." *Common Cause Indiana*, 800 F.3d at 927.

A third and final argument in favor of partisan balance requirements—the "whistleblower theory"—highlights the monitoring role of minority members on commissions and courts (Cross and Tiller 1998; Tiller and Cross 1999; Barkow 2010; Jacobs 2017; Hazelton, Hickman, and Tiller 2018). According to the whistleblower theory, a key function of minority members is to sound a "fire alarm" when members of the majority party issue an egregiously ideological decision. By writing a dissenting opinion or otherwise voicing their disapproval, minority party members attract the attention of higher-level courts, legislators, or others who can evaluate whether the majority has strayed too far to an extreme and take corrective action. Installing one or more ideological minorities on a commission or court thus reduces monitoring costs: instead of scrutinizing every commission action and court decision, lawmakers and voters can focus their limited attention on cases in which minority members have blown their whistles.

Although most scholarship on partisan balance requirements emphasizes the potential benefits of these provisions, the requirements are not without their costs. Most significantly, partisan balance requirements limit the pool of candidates for each opening on a commission or court. This limitation may be particularly problematic in a small state such as Delaware that is dominated by one political party—especially if the partisan balance regime includes an other-major-party reservation. As of this writing, only 27 percent of Delaware voters were registered Republicans (Delaware Board of Elections 2024), and the small pool of Republicans may make it difficult for governors to find qualified nominees when a Republican seat on a state court opens up.

Another concern regarding partisan balance requirements is that these provisions may have the unintended consequence of deepening party divisions, resulting in hyperpartisanship rather bipartisanship. Responding to a proposed partisan balance regime for the U.S. Supreme Court, Sachs (2019, p. 98) writes: "Permanently labeling certain Justices as Democrats or Republicans—making their party membership the very condition of their holding their seats—raises rather than lowers the salience of partisanship" and "undermines, rather than supports, the . . . idea of law itself, as an enterprise separate from politics."

Defenders of Delaware's judicial selection system contest that claim. For example, one longtime Delaware jurist argues that the state's constitutional partisan balance regime has "result[ed] in a centrist group of jurists committed to the sound and faithful application of the law" (Strine 2005, p. 683). However, Sachs's hyperpartisanship hypothesis illustrates that the effects of partisan balance requirements are theoretically ambiguous, further underscoring the need for empirical evaluation of these regimes.

3. Empirical Literature on Partisan Balance Requirements

To date, the empirical literature on partisan balance requirements has focused entirely on federal agencies. All of these studies have sought to answer the same question: Do partisan balance requirements meaningfully affect the ideological composition of multimember bodies? In theory, a Democratic president might appoint the most liberal Republican she can find when a partisan balance requirement prevents her from naming another Democrat to an open seat on a commission

(and likewise, a Republican president might seek out a conservative Democrat). The risk of circumvention is even higher when—as has long been true at the federal level—the partisan balance regime includes only a bare-majority limitation without an other-major-party reservation. For example, a Democratic president would comply with the letter (though not the spirit) of the federal partisan balance statutes if she appointed Green Party members or liberal independents to open seats on commissions with a bare majority of Democrats.

To assess whether partisan balance requirements meaningfully constrain federal agency appointments, Nagel and Lubin (1964) examine voting patterns across seven federal commissions subject to partisan balance requirements. The authors calculate the percentage of "liberal" votes cast by each member in non-unanimous adjudications (interpreting, for example, a vote by a National Labor Relations Board member in favor of labor in a labor-management controversy as "liberal"[4]). The authors find—to their surprise—that "Democratic commissioners appointed across party lines" (i.e., Democratic commissioners appointed by Republican presidents who are compelled by partisan balance requirements to name a non-Republican to an open seat) "seemed to be even more liberal than Democratic commissioners appointed within party lines" (Nagel and Lubin 1964, p. 44). The authors further find that Republican commissioners appointed by Democratic presidents are less liberal than Democrats appointed by Democratic presidents, though still markedly more liberal than Republicans appointed by Republican presidents. Consistent with the notion that partisan balance requirements really do affect the ideological composition of multimember bodies, the results suggest that when partisan balance requirements prevent presidents from placing co-partisans in open seats, presidents respond by appointing opposite-party members whose views diverge significantly from the president's own.

Several other studies center on a single agency—the Federal Communications Commission (FCC)—and consider the effect of partisan balance requirements on that body. Gormley (1979) examines nonunanimous FCC votes from mid-1974 to mid-1976—a period in which all seven commission members had been appointed or reappointed by President Nixon—and concludes that Republican commissioners were much more likely than Democratic commissioners to vote in favor of industry. According to Gormley (1979, p. 681), these results suggest that "regulatory agencies could change dramatically if presidents were permitted to appoint an unlimited number of members of their own party to regulatory agencies." By contrast, Cohen (1986) examines all nonunanimous FCC decisions over a 19-year stretch (1955 through 1974) and finds that, controlling for the party of the appointing president, an individual commissioner's partisan affiliation has no statistically significant effect on the probability of casting a pro-industry vote. Cohen explains this null result by noting that the parties "are not always ideologically cohesive" and that the Democratic Party—at least during the period of Cohen's study—included a substantial number of conservative southerners (Cohen 1986, p. 698). In the most comprehensive analysis of FCC voting, Ho (2007) examines all published adjudications and rulemakings by the FCC from

[4] Although the National Labor Relations Board is often classified as an agency subject to a partisan balance requirement, there is no statutory limit on the number of board members from a single party (Bodah 2001; Brudney 2005). Nonetheless, every president since John F. Kennedy has honored an informal norm of naming no more than three members of his own party to the five-member board (Feinstein and Hemel 2018, p. 54 n.131).

1965 to 2006 and uses a sophisticated Bayesian model to map votes onto a liberal-conservative spectrum. Consistent with Gormley and contra Cohen, Ho finds "resounding evidence" that "partisanship requirements constrain": presidents do not simply seek out cross-party appointees "in sheep's clothing" when partisan balance requirements bar them from appointing a member of their own party (Ho 2007, p. 25).

One limitation of the above-mentioned studies is that they all estimate commissioner ideology based on voting patterns, which are endogenous to commission composition. Feinstein and Hemel (2018) adopt a different approach, using data on individual commission members' lifetime campaign contributions to place appointees on an ideological spectrum. Our analysis—which covers 23 agencies from the Carter to Obama administrations—finds robust support for the view that partisan balance requirements constrain presidential appointments. Moreover, the effect of partisan balance requirements appears to have grown over time. President Carter's Republican appointees to agencies with partisan balance requirements were only modestly more conservative than his Democratic co-partisans, but by the 1990s, the ideological gap between co-party and cross-party appointees had widened significantly. We attribute this finding primarily to the phenomenon of "partisan sort": since the late 1970s, liberal Republicans have largely migrated to the Democratic Party, while conservative Democrats have mostly moved to the Republican side. One consequence of "partisan sort" is that even a president who wants to appoint a cross-party appointee "in sheep's clothing" (i.e., a Democratic president who wants to appoint a liberal Republican or a Republican president who wants to appoint a conservative Democrat) may struggle to find a qualified nominee who fits the ideological bill.

Notably, the extant literature has not meaningfully addressed whether partisan balance requirements affect the perceived quality of those bodies' decisional outputs. One reason for this lacuna in the literature is that, at least at the federal level, partisan balance regimes rarely change: partisan balance requirements are usually written into an agency's organic statute at inception, thus precluding the possibility of a before-and-after comparison. Another reason is that for most agencies, there is no revealed-preference measure of the value that regulated parties and other affected interest groups assign to the agency's institutional features. As we explain below, the *Adams* litigation—which threw Delaware's judicial partisan balance requirements into flux—offers an unusual and possibly unique natural experiment in which a partisan balance regime underwent a series of exogenous shocks that generated measurable responses from a key set of stakeholders.

B. Delaware's Dominance in the Market for Corporate Charters

Market reactions to the *Adams* litigation merit careful empirical examination not only because they can shed light on the effects of partisan balance requirements but also because they can inform the debate over Delaware's dominance in corporate charter competition. More than 60 percent of publicly traded companies in the United States are incorporated in Delaware (Larcker and Tayan 2020). Scholars have long sought to understand why so many firms flock to America's sixth least populous state. One group of scholars argues that firms choose to incorporate in Delaware because of desirable features of Delaware law that increase shareholder wealth (e.g., Romano 1985). Others argue that the "Delaware effect" on firm value is illusory and that companies choose to incorporate or reincorporate in Delaware for reasons other than shareholder wealth maximization. The natural experiment created by the *Adams* litigation can contribute to this debate by revealing whether, and to what extent, investors value one important feature of Delaware's legal landscape.

Studies of the "Delaware effect" on firm value typically follow either of two methodological approaches. One set of studies tests for this effect by comparing Delaware and non-Delaware firms based on the ratio between their market value and their book value, a measure labeled "Tobin's *q*." These studies operate on the assumption that the market value of a firm's securities relative to the book value of its assets reflects the quality of its corporate governance. Empirical evidence on the question of whether Delaware-incorporated firms have higher Tobin's *q* values is mixed, producing differing results depending on the time period studied and whether a controlling shareholder exists (e.g., Fox 2020, Subramanian 2004, Daines 2001). Others challenge the reliability of Tobin's *q* as a measure of the effect of corporate law and governance on firm value.[5]

A second set of studies examines short-term stock price reactions to firms' announcements of their intention to reincorporate in Delaware. Bebchuk, Cohen, and Ferrell (2002) identify six such event studies with reliable methodologies. The average abnormal return across those six studies—weighted by sample size—is approximately 1.2 percent. The authors therefore argue that "even if the positive abnormal stock price reaction is entirely due to the benefits of Delaware incorporation, these benefits appear to be rather modest" (Bebchuk, Cohen, and Ferrell 2002, p. 1792). Bhagat and Romano (2007, p. 971) respond that "an investment project that generates positive abnormal returns of even 1 percent is considerable for competitive capital markets." Both

[5] For instance, Dybvig and Warachka (2015) observe that a shareholder wealth-maximizing firm will invest in new projects up to the point that an additional $1 of investment adds $1 to its market value. Thus a Tobin's *q* significantly higher than 1 may reflect inefficient underinvestment rather than good governance. Barlett and Partnoy (2020) and Catan and Kahan (2021) list a range of other flaws with the use of Tobin's *q* as a measure of corporate performance. For example, imagine that a firm with a Tobin's *q* of 1 invests $1 in an advertising campaign that increases the net present value of its future cash flows by only $0.99. The advertising campaign will increase the firm's Tobin's *q*—even though it reduces shareholder wealth—because the investment decreases the book-value denominator by more than it depresses the market-value numerator.

sets of authors accept 1 percent as a reasonable approximate estimate of the positive abnormal return associated with reincorporation into Delaware.

As their advocates will acknowledge, event studies that focus on reincorporation decisions suffer from important limitations. Since firms often reincorporate in Delaware in conjunction with other changes to their business strategy or governance structure—such as the consummation of a merger or the adoption of a takeover defense—event studies may not be able to distinguish the effects of Delaware law from other factors associated with reincorporation. And apart from any concerns about confounding factors, short-term event studies measure only the effect of reincorporation on investors' *expectations* regarding a firm's future profitability (Fisch, Gelbach, and Klick 2018). As Catan and Kahan (2021) caution, "[t]he market's expectations, however, may be wrong." Still, the same authors conclude that even with these shortcomings, event studies are "greatly superior" to Tobin's q regressions in measuring the effect of corporate law and governance changes on firm value. And again, most—though not all[6]—of these event studies find a positive price effect immediately after firms reincorporate in Delaware.

To the extent that a Delaware charter confers an advantage on firms incorporating there, what features of the state's legal landscape might account for this "Delaware effect"? The two leading accounts are sometimes described as the "credible commitment theory" and the "network theory" (Molk 2021, p. 1117; Matera 2022, p. 77). The credible commitment theory, first developed by Romano (1985) and elaborated in Romano (1993), starts from the premise that corporate law is a "product" sold by states to firms. According to this theory, firms incur nontrivial costs when they switch "products" (i.e., when they change their state of incorporation). To avoid further costly switches, firms seek out states that precommit to being responsive to the needs and desires of their corporate "customers."

Proponents of the credible commitment theory argue that Delaware enjoys several advantages that allow it to precommit to a high-quality corporate law regime. The state's small size—and the correspondingly outsized impact of corporate franchise tax revenues on its budget[7]—render Delaware "hostage" to the interests of its corporate customers. Furthermore, Delaware has invested in a number of "real assets"—including "a comprehensive body of case law, judicial expertise in corporation law, and administrative expertise in the rapid processing of corporate filings"—that "have no use outside the chartering business" (Romano 1993, p. 39). The sunk costs of these investments would be lost if Delaware ever abandoned its position as a go-to destination for corporate charters. For all these reasons, firms that choose to incorporate or reincorporate in Delaware can be confident that the state will maintain the quality of its most profitable product.

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[6] Anderson and Manns (2015) add to this event study literature by examining stock price reactions to mergers between Delaware and non-Delaware firms. Specifically, they focus on the effect of mergers on the combined values of targets and acquirers. They find that there is no statistically significant difference in the combined price effect based on whether the post-merger firm is incorporated inside or outside Delaware.

[7] As of 2021, corporate license fees accounted for 12.1 percent of Delaware's state and local general revenue, as compared to a national average of 0.2 percent (Urban Institute 2024).

Although Romano does not mention Delaware's constitutional partisan balance requirements in her trailblazing account of Delaware's dominance,[8] several other scholars and jurists highlight the state's partisan balance regime in explaining Delaware's corporate chartering success. Norman Veasey, who served for 12 years as chief justice of the Delaware Supreme Court, writes that "[t]he constitutional requirement of a bipartisan judiciary"—because of its depoliticizing effect—"has led, in my opinion, to Delaware's international attractiveness as the incorporation domicile of choice" (Veasey with Di Guglielmo 2005, p. 1402). Randy Holland, who served on the Delaware Supreme Court for 31 years, adds that "Delaware's continued preeminence in corporate law is contingent on not only the perception but the reality that the Delaware judiciary is engaged in principled decisionmaking"—a perception and reality that he attributes to the state's "practice of appointing judges and maintaining a balance of power between the political parties on its high courts" (Holland 2009, pp. 771-772).

Eldar and Rauterberg (2023) provide the most developed account of the relationship between Delaware's partisan balance regime and the state's dominant position in the market for corporate charters. They frame their account as an extension of Romano's credible commitment theory: according to Eldar and Rauterberg, Delaware bolstered the credibility of its commitment to a high-quality corporate law product by taking "deliberate steps to restrict the influence of political partisanship on the creation of its corporate law" (Eldar and Rauterberg 2023, p. 207). The authors place particular emphasis on the bare-majority limitation in the state's 1897 constitution, which was adopted just as the state was preparing to mount a challenge to New Jersey's then-preeminent position in the market for corporate charters. "When Delaware made a firm commitment in 1897 to a bipartisan judiciary—and thus, nonpartisan adjudication—other states competing for incorporations failed to do so," Eldar and Rauterberg observe. "This enduring commitment likely facilitated the evolution of judicial expertise in corporate law that forms part of Delaware's alluring product for corporations today" (Eldar and Rauterberg 2023, p. 221).

Alongside the credible commitment theory, the network theory—first developed by Klausner (1995)—offers the other most prominent explanation for Delaware's dominance in corporate chartering. Klausner argues that Delaware's success in the market for corporate charters is "self-reinforcing": when firms incorporate in Delaware, they gain access to the "network benefits" of Delaware corporate law, and these benefits increase as the network grows larger. Klausner identifies three potential sources of network benefits. First, Delaware firms may face less legal uncertainty than non-Delaware firms because of the steady stream of Delaware judicial precedents interpreting common terms in corporate contracts. Second, Delaware firms may pay less for legal services than firms incorporated in other states because attorneys are more familiar with Delaware corporate law than with non-Delaware corporate law. And third, Delaware courts may develop greater expertise in corporate law matters than courts in other states because Delaware courts adjudicate such a high volume of corporate cases.

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[8] Instead, she emphasizes another feature of the state's constitution: a supermajority provision that requires a two-thirds vote of the state's house and senate for any legislative change to Delaware corporate law (Romano 1985, pp. 241-242; Romano 1993, p. 41-42).

Sanga (2020) presents a creative empirical test of the network theory by examining the effect of new Delaware incorporations on the value of existing Delaware firms. Sanga focuses on the four-year period starting in June 1986, when Delaware's adoption of a liability-limiting provision for corporate directors set off a surge of Delaware reincorporations. Sanga finds that Delaware firms significantly outperformed non-Delaware firms during this period of rapid network expansion: a zero-investment portfolio that was long on Delaware firms and short on non-Delaware firms would have earned abnormal returns of more than 3 percent per year during the 48-month stretch. Sanga goes on to provide suggestive evidence that the success of Delaware firms over that interval was due to the increase in the size of the Delaware network rather than the liability-limiting provision itself.

The credible commitment theory and the network theory are potentially complementary—not necessarily competing—accounts of the Delaware effect on shareholder wealth. It is possible that unique features of Delaware law—including its credible commitment to the corporate law "product" and its constitutional commitment to a bipartisan judiciary—attract firms to the state and add to shareholder wealth, while network effects augment the benefits of legal quality. As explained below, our empirical strategy allows us to distinguish the effect of partisan balance from other elements of credible commitment theory, but nothing in our analysis rules out the coexistence of positive network externalities.

C. The *Adams* Litigation

Our ability to estimate the shareholder wealth effects of Delaware's partisan balance regime arises from the long-running litigation in *Adams v. Carney*. The plaintiff in that case, James Adams, is a retired prosecutor and longtime Democrat who changed his voter registration to "unaffiliated" shortly before filing his lawsuit in February 2017. Adams—who described himself in a deposition as "more of a Bernie [Sanders] independent"[9]—said that he decided to challenge Delaware's partisan balance regime after reading a law review article (Friedlander 2016) arguing that Delaware's judicial selection scheme is unconstitutional. Borrowing arguments from that article, Adams alleged in his federal court complaint that Delaware's partisan balance regime violates the First Amendment freedom of association because it discriminates on the basis of party affiliation, thus depriving lawyers like him who are neither Democrats nor Republicans of opportunities for judicial appointments. Adams asked the federal district court to enjoin the use of party affiliation as a criterion for appointing Delaware state judges.[10]

The lawsuit drew little notice from the business press until December 6, 2017, when Magistrate Judge Mary Pat Thynge granted Adams's motion for summary judgment.[11] In her decision, Magistrate Judge Thynge ruled that the state's partisan balance regime "violates the First

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[9] Complaint 10, Adams v. Carney, No. 1:17-cv-00181 (D. Del. Feb 21, 2017).

[10] Joint Appendix 74, Adams v. Carney, No. 18-01045 (3d Cir. July 18, 2018).

[11] The first reference to the case on the Bloomberg Terminal News service came on December 6, 2017, the date of the district court decision. The Deal Pipeline, a web-based transaction information service, mentioned the suit in a March 2017 article (Marcus 2017), but other financial publications did not pick up the story until the December 2017 district court ruling.

Amendment by placing a restriction on governmental employment based on political affiliation." Although acknowledging that governmental employers may consider party affiliation when vetting candidates for "policymaking positions," Magistrate Judge Thynge held that the "narrow exception" for policymaking posts "does not apply because the role of the judiciary is to interpret statutory intent and not to enact or amend it." Contrary to the claims of scholars and jurists who argue that a bipartisan judiciary is essential to Delaware's corporate law preeminence, she concluded that "[p]olitical affiliation is not important to the effective performance of a Delaware judge's duties."[12]

The defendant in the case, Delaware Governor John Carney, initially responded with a motion urging the district court to reconsider its decision, which Magistrate Judge Thynge denied on May 23, 2018.[13] The governor then pursued an appeal to the U.S. Court of Appeals for the Third Circuit, which unanimously affirmed the district court's decision on April 10, 2019. The three-judge panel held—consistent with the district court's analysis—that the other-major-party reservation for Delaware judges flunked First Amendment scrutiny because it unnecessarily infringed on the associational rights of judicial candidates. While the panel did not directly address the constitutionality of the bare-majority limitation, it held that the bare-majority limitation is not "severable" from the other-major-party reservation because "we do not think the two components were intended to operate separately."[14] This was a striking conclusion given that the Delaware constitution had included a bare-majority limitation without an other-major-party reservation from 1897 to 1951—and it was even more surprising given that Congress routinely applies bare-majority limitations to federal agencies without other-major-party reservations.

The governor petitioned for rehearing en banc (i.e., rehearing by the full Third Circuit). Rehearing en banc is an exceedingly rare event—a "judicial hole in one" (Rauchberg 2005)—and federal appellate courts grant rehearing en banc in less than 1 percent of cases (Nielson and Stancil 2022). Perhaps not unexpectedly, then, the Third Circuit denied rehearing en banc on May 7, 2019. Notably, though, four of the court's fourteen then-active judges voted to grant rehearing en banc and chose to make their votes public.[15] Those four dissenters included several of the court's most prominent judges. Two of the four—Thomas Hardiman and Stephanos Bibas—have acquired reputations as "feeder judges" whose clerks routinely go on to clerk for Supreme Court justices (Zoppo 2023). Hardiman also had been a finalist for the Supreme Court nomination that ultimately went to now-Justice Neil Gorsuch, with the *New York Times* noting afterwards that the judge "might be considered for future Supreme Court appointments" (Thrush and Haberman 2017). Moreover, the group of four justices included appointees of Democratic and Republican presidents, indicating that their dissatisfaction with the panel's decision was more than an ideological gripe. Thus, although the immediate outcome of the en banc rehearing petition was

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[12] Adams v. Carney, No. CV 17-181-MPT, 2017 WL 6033650, at *6 (D. Del. Dec. 6, 2017).
[13] Adams v. Carney, No. CV 17-181-MPT, 2018 WL 2411219 (D. Del. May 23, 2018).
[14] Adams v. Governor of Delaware, 922 F.3d 166, 183 (3d Cir. 2019).
[15] Order, Adams v. Governor of Delaware, No. 18-01045 (3d Cir. May 7, 2019).

negative from the governor's perspective, the bipartisan dissents arguably indicated that the case was ripe for Supreme Court review.

Governor Carney then filed a petition for certiorari. His petition argued that the state courts' partisan balance requirements contribute to Delaware's ability to credibly commit to a high-quality corporate law product. "Delaware's well-earned reputation for impartiality and expertise is one reason that companies choose to charter there," Carney asserted. "Delaware judges have concluded that the greater objectivity and consensus within the Delaware judiciary is due at least in part to its political balance provisions."[16]

On December 6, 2019, the Supreme Court announced that it would add the case, now captioned *Carney v. Adams*, to its merits docket. Since the petitioning party ultimately wins in more than two-thirds of merits cases at the Supreme Court (Roeder 2015), the grant of certiorari was a strong positive signal that Delaware's partisan balance regime would survive in at least some form.

The merits briefing also emphasized the importance of high-quality courts to businesses' decisions to incorporate in Delaware and the key role that partisan balance requirements play in enhancing that reputation. Writing as amici, a bipartisan group of five former Delaware governors asserted that "Delaware's status as the center of United State corporate law [is] anchored by a specialized, nonpartisan judiciary." The loss of that status, they claimed, "would harm Delaware-incorporated businesses nationwide."[17] In its amicus brief, the U.S. Chamber of Commerce asserted that the quality of Delaware courts—"the crown jewel of the state court system"—attracts firms to incorporate in the state. Invalidating these courts' partisan balance requirements, the Chamber argued, would threaten that preeminence, "by dismantling the protections that have helped insulate [Delaware courts] from partisan influence and entrenchment."[18]

Oral argument was held on October 5, 2020 and livestreamed online to the public (Córdova 2021). The justices led off with tough questions for the governor's lawyer, Michael McConnell. A former federal judge and current constitutional law professor at Stanford, McConnell argued that Adams lacked constitutional standing to challenge the partisan balance regime because Adams had not actually applied for a judgeship or shown concrete plans to do so in the near future. Several justices seemed skeptical of McConnell's standing argument. Adams "said that he would consider and apply for the next available judicial position," Chief Justice John Roberts told McConnell. "He said that under oath . . . . [W]hat more does he have to do?" Justice Elena Kagan expressed similar doubts: "[A]s long as this constitutional provision is in effect, and he's an Independent, he's not going to get a position," Kagan said of Adams. "[S]o why would we insist that he have to file an application?" Several justices also expressed concerns about Delaware's exclusion of independents from its judiciary. For example, Justice Brett Kavanaugh noted a "mismatch"

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[16] Petition for Writ of Certiorari 32-33, Carney v. Adams, No. 19-309 (U.S. Sept. 4, 2019).
[17] Brief for Former Governors of the State of Delaware as *Amici Curiae* in Support of Petitioner 10, Carney v. Adams, No. 19-309 (U.S. Jan. 28, 2020).
[18] Brief for the Chamber of Commerce of the United States as *Amicus Curiae* in Support of Petitioner 1, Carney v. Adams, No. 19-309 (U.S. Jan. 28, 2020).

between the state's asserted goal of judicial nonpartisanship and the effective bar on politically unaffiliated judges. "[W]ouldn't you agree," Kavanaugh asked McConnell, "that Independents could serve the purpose of achieving a balanced nonpartisan or bipartisan judiciary?"[19]

The justices also asked probing questions—particularly on the issue of standing—to Adams's attorney. Court watchers came away from the argument with mixed predictions about the outcome. "[M]y prognosis is that a majority is likely to hold that Adams does have standing," and after that, "all bets are off," wrote law professor Rodney Smolla in the legal publication *Law360* (Smolla 2020). *New York Times* Supreme Court correspondent Adam Liptak wrote that it was "possible" that the court would rule that the plaintiff lacked standing, though also possible that it "would strike down only the provision limiting appointments to candidates affiliated with the major parties" (Liptak 2020).[20]

The Supreme Court issued its decision on December 10, 2020—an unusually quick turnaround time. Writing for a unanimous court, Justice Stephen Breyer concluded that Adams did indeed lack constitutional standing to challenge Delaware's judicial selection system. "[T]he record evidence fails to show that, at the time he commenced the lawsuit, Adams was 'able and ready' to apply for a judgeship in the reasonably foreseeable future," Breyer wrote.[21] The court therefore vacated the Third Circuit's judgment and remanded with instructions to dismiss Adams's case. Without addressing any of the arguments for or against the constitutionality of Delaware's scheme, the justices effectively breathed new life into both the bare-majority limitation and the other-major-party reservation.

Just hours after the justices handed down their decision, Adams was back in federal district court to renew his constitutional challenge—this time with evidence that he had applied for three state judicial vacancies since 2017 and been rejected on all three occasions.[22] The governor asked the court to dismiss the case again for lack of standing, but Judge Maryellen Noreika ruled on September 23, 2022, that Adams had met the standing requirement through his new judicial applications.[23] The parties soon entered settlement negotiations, and on January 30, 2023, they jointly submitted a proposed consent judgment to the court that preserved the Delaware Constitution's bare-majority limitation but declared the other-major-party reservation to be unenforceable. Judge Noreika approved the consent order the same day.[24]

Both sides declared victory. "Mr. Adams is happy to have reached a positive result," his attorney told *Law360*. "It's been a long slog, but definitely worth the effort," the lawyer added. The governor's office struck a similarly upbeat tone. "This settlement protects Delaware's long-standing and vital interest in avoiding partisan domination of the courts by preserving the 'bare

[19] Oral Argument, Carney v. Adams, No. 19-309, 2020 WL 6203592 (U.S. Oct. 5, 2020).
[20] Court reporter Amy Howe's description of the oral argument also gives reason to believe that the case could go either way (despite her article's headline) (Howe 2020).
[21] Carney v. Adams, 592 U.S. 53, 63 (2020).
[22] Complaint, Adams v. Carney, No. 1:20-cv-01680 (D. Del. Dec 10, 2020).
[23] Adams v. Carney, No. CV 20-1680 (MN), 2022 WL 4448196 (D. Del. Sept. 23, 2022).
[24] Stipulated Consent Judgment and Order, Adams v. Carney, No. CV 20-1680 (D. Del. Jan. 30, 2023).

majority' provisions in our constitution," Governor Carney's communications director said. "That will help ensure that Delaware's courts continue to be recognized as the preeminent court system in the country" (Montgomery 2023).

The upshot is that Delaware's constitution no longer requires that the governor appoint a Republican to an open seat on the state supreme, chancery, or superior court when a bare majority of members are Democrats. But so far, Governor Carney—a Democrat—has not used his newfound discretion to name left-leaning independents or Green Party members to the bench. Since January 2023, the governor has had one opportunity to name a new judge to a historically Republican seat: a superior court judgeship in New Castle County. Carney nominated Sean Lugg, a longtime state prosecutor and—according to online voting records—a registered Republican (Krebs 2023; VoterRecords.com 2024).

II. Research Design

A. Hypotheses

1. Major Events

In light of the myriad claims that Delaware courts' partisan balance provisions improve decisional quality, which in turn is a key feature of the corporate law "product" that Delaware offers to firms, we theorize that investors value partisan balance on Delaware's courts. Events in the *Adams v. Carney* case offer a means of testing this theory. Although no single event in that litigation presented a final, durable settlement of the constitutionality of the state's partisan-balance requirements, we focus on two key judicial decisions in the litigation that materially altered the probability that the requirements would survive.

First, the district court's grant of summary judgment to Adams on December 6, 2017, marked the first time that any court had held that the state's partisan balance regime violates the First Amendment. We hypothesize that investors reacted negatively to this development. If the district court's decision were to stand, the invalidation of Delaware courts' partisan balance requirements would eliminate what is considered a source of the state judiciary's perceived quality and component of the celebrated "Delaware effect."

Of course, the district court presumably was not expected to have the final word on the question; indeed, Delaware noticed its appeal to the Third Circuit one month later. Nonetheless, we posit that the district court's decision shifted observers' priors downward regarding whether Delaware's partisan balance requirements would survive. That reasoning motivates our first testable hypothesis:

> <u>Hypothesis 1</u>: Delaware-incorporated public companies exhibit abnormal negative returns on the date on which the district court invalidated the state judiciary's partisan-balance requirements.

Second, the U.S. Supreme Court's decision on December 10, 2020, effectively wiped the district court's ruling from the books. Like the district court's decision, the Supreme Court's judgment did not purport to be the final word on the matter. In holding that Adams lacked standing, the Court did not reach the merits, and thus left the door open to the prospect of Adams or another litigant bringing suit in the future. Nonetheless, the Court's decision presumably shifted observers' expectations yet again. Prior to the Supreme Court's decision, the status quo ante was that Delaware's partisan balance requirements are unconstitutional and must be interred. After December 10, their future looked more optimistic. For Delaware, the worst-case eventual outcome would be that a proper plaintiff files suit and, after the case winds its way through the federal courts, succeeds in invalidating the requirements. That process would take years; consider that nearly four years elapsed between Adams filing his complaint February 2017 and the Supreme Court's December 2020 decision. In the interim, partisan balance on Delaware's courts would endure.

Furthermore, the Supreme Court's decision preserved the prospect that a later suit by a proper plaintiff would yield a more favorable outcome for Delaware—which it turns out is what actually happened. As noted, Adams and Delaware ultimately entered into a settlement that allowed the state's bare-majority limitation to survive but scrapped the other-major-party reservation. Relative to the district court and Third Circuit decisions in the first lawsuit, where Delaware lost on both of these issues, the settlement constitutes a major improvement for the state. Similar bare-majority provisions for federal multimember agencies have generally resulted in roughly equal representation for Democrats and Republicans, even without an other-major-party rule (Feinstein and Hemel 2018). The federal experience suggests that of the two longstanding elements of the Delaware's partisan balance regime, the bare-majority limitation has the larger impact on the composition of the state's judiciary.

Accordingly, Hypothesis 2 reflects our expectation that investors would interpret the Supreme Court's vacatur as good news for Delaware firms:

> Hypothesis 2: Delaware-incorporated companies produce abnormal positive returns on the date on which the Supreme Court remands *Carney v. Adams* with instructions to dismiss the lawsuit.

Although these hypotheses are well-grounded, they also may be reversible. In other words, it is possible that market participants *disfavor* judicial partisan balance requirements, and thus react positively to the district court's decision and negatively to the Supreme Court's opinion. Most cases before the Delaware Chancery Court or Supreme Court are decided by a subset of chancellors or justices, who typically are selected via random assignment.[25] Random selection from a balanced pool of Democratic and Republican jurists may make case outcomes less predictable ex ante than they would be if Democrats dominated the bench—a likely scenario, given that Democrats have held Delaware's governorship for three decades. Furthermore, market participants may believe

[25] Delaware Supreme Court Internal Operating Procedures, Rule IX (2024).

that partisan balance requirements reduce the quality of the Delaware judiciary by limiting the pool of candidates for open seats on the states' courts or that the explicit identification of judges with parties contributes to hyperpartisanship (see Sachs 2019).

We therefore are mindful of the possibility that events in *Adams* may have the opposite price effect from our hypotheses. Accordingly, we also offer an alternative hypothesis: that important events in the *Adams* litigation are associated with abnormal *absolute* returns. This alternative hypothesis does not offer a position on the direction of the effects. Thus, whereas two-sided tests of statistical significance often are inappropriate in securities event studies (Fisch, Gelbach, and Klick 2018), they are sensible here.

2. Other Events

To be sure, the district court's summary-judgment grant to Adams and the Supreme Court's remand with instructions to dismiss were not the only consequential decisions in this long-running litigation. Importantly, however, these were the only decisions that altered the legal status of Delaware's bare-majority limitation—the most significant element of the state's partisan balance regime. By contrast, other rulings, such as the Third Circuit's affirmance of the district court's decision and the Supreme Court's choice to take up the case, still left the legal status quo in place.

We do not expect status quo-preserving actions to affect markets to the same extent as judicial decisions that alter the legal landscape. Therefore, we restrict our main hypotheses to the two actions that rupture the status quo. Nonetheless, even status quo-preserving actions along the path to the matter's ultimate resolution presumably will shift observers' priors regarding the likelihood of a given outcome. For example, if an observer believes that partisan balance requirements have an n percent likelihood of survival following an adverse district court decision, a later circuit court decision affirming the district court may reduce that perceived likelihood to $n-k$ percent.

Accordingly, we also analyze investors' responses to six other important decision points in the *Adams* litigation. These six other actions are:

<u>1. Denial of motion for reconsideration.</u> On May 23, 2018, the district court denied Carney's motion for reconsideration. By allowing its decision to stand, the court extinguished the first of several opportunities for possible judicial reversal. Consistent with the theory that investors value partisan balance requirements, we hypothesize that Delaware firms will witness abnormal negative returns on this date.

<u>2. Circuit court affirmance.</u> On February 5, 2019, the Third Circuit issued a panel decision affirming the district court. We expect abnormal negative returns on this date for a similar reason as above.

<u>3. Denial of petition for rehearing en banc.</u> On May 7, 2019, the Third Circuit denied Carney's petition for rehearing en banc. Ordinarily, one would expect abnormal negative returns following this decision, since en banc review presents an additional opportunity for judicial reversal. But as noted above, the circumstances of the Third Circuit's denial of rehearing en banc—

with four judges, including two top "feeder" judges, dissenting from the denial—complicates causal inference, as those dissents may have signaled an increased probability of Supreme Court review. Given these cross-cutting considerations, we do not offer a hypothesis regarding abnormal returns on this date.

4. Cert grant. On December 6, 2019, the Supreme Court granted Carney's petition for writ of certiorari. Because the Supreme Court reverses the lower-court judgments in most of the appeals that it hears (Katz et al. 2017), we presume that this grant substantially increased the likelihood that Delaware's partisan-balance requirements would survive. Thus, we hypothesize that Delaware-incorporated firms will experience abnormal positive returns on this date.

5. Oral argument. On October 5, 2020, the Supreme Court heard oral argument in the case. The Court streamed the argument live on its website beginning at 10:04 a.m., which enabled interested investors, early in the trading day, to listen for clues regarding how the Court might rule. After all, research shows that the content and tone of justices' questions during oral argument can be predictive of the Court's ultimate disposition (see Black et al. 2011 for an overview).

Once again, we do not offer a firm hypothesis for the effect of oral argument on trading markets due to cross-cutting considerations. As noted, a majority of justices did not appear to clearly favor either side in their questioning in this case, and post-argument media reactions were mixed. Even if one received a strong signal of the Court's intentions from oral argument, however, the predictive power of this measure is relatively small; sophisticated models of oral argument content on case outcomes improve accuracy over the "petitioner always wins" baseline only by 2.0 to 4.5 percentage points (Kaufman, Kraft, and Sen 2019).

6. Settlement. Finally, the consent judgment ending the litigation—entered on January 30, 2023—does not generate a straightforward prediction regarding market reactions. On one hand, Delaware's concession that the other-major-party restriction violates the U.S. Constitution arguably weakens the state's partisan balance regime, even though the bare-majority limit survives. Further, Adams's acknowledgment that the bare-majority restriction remains enforceable does not prevent other Delawareans with standing from challenging that provision—or from using the same arguments that Adams successfully deployed at every stage at which a court reached the merits. These features suggest that Delaware-incorporated firms should experience abnormal negative returns on the settlement date. On the other hand, the fact Delaware agreed to the settlement provides suggestive evidence that the state preferred the deal's terms to rolling the dice in court. And again, evidence from federal multimember agencies indicates that the bare-majority requirement on its own could produce a judiciary with nearly equal numbers of Democrats and Republicans (Feinstein and Hemel 2018). That Adams—thus far the only plaintiff willing to challenge the state's partisan balance regime—agreed to drop his opposition to the bare-majority limitation therefore arguably qualifies as a win for the state. By this logic, Delaware-incorporated firms should experience abnormal positive returns on the settlement date. Given these competing theories, we do not offer a hypothesis regarding abnormal returns on the settlement date.

B. Data

Our research design requires data on the jurisdiction of incorporation for U.S. public companies, other features of these companies, and daily stock returns. We obtain most of these data from the Center for Research in Security Prices (CRSP).[26] For each event in our study, we identify all Delaware-incorporated companies in the CRSP data.

The sample is restricted to public companies listed on the two largest U.S. stock exchanges, NYSE and NASDAQ. Publicly traded investment funds (e.g., exchange-traded funds) and other publicly traded financial vehicles are excluded from the analysis. The sample runs from June 13, 2017 to April 12, 2023, which corresponds to 120 trading days before the district court's grant of summary judgment through 50 trading days after the consent judgment ending the *Adams* litigation. In all, the sample consists of 3.0 million company-trading days. It includes 2,865 Delaware-incorporated companies and 1,424 companies incorporated elsewhere in the United States.[27]

Table 1 provides descriptive statistics concerning these companies. As the table shows, Delaware corporations tend to have substantially larger market capitalizations and greater liquidity than do firms that are incorporated in other states.

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[26] The exception is that data on stock-price momentum was obtained from Kenneth French's data library. See "Momentum Factor [Daily]," https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.

[27] Not every company is included for each event study. Some companies were listed for only a portion of the 70-month period, whereas others had insufficient trades during the estimation windows preceding some events.

For companies that reincorporate from one state to another, CRSP only reports their most recent state of incorporation. Accordingly, for some companies the reported state of incorporation may not accurately reflect the state of incorporation on the event date. The number of companies for which this error applies, however, is likely small. Consider that among the over 22,000 companies listed on a major U.S. stock exchange for some portion of the 1930-2010 period, only 6.9% changed their incorporation state either from or to Delaware at any point during this 80-year period (Sanga 2020, tbl. 1). The proportion that changed their incorporation state between mid-2017 (when the estimation window for the first event in this analysis began) and 2024 (when we downloaded CRSP data on firms' states of incorporation) is presumably much lower.

Table 1: Characteristics of Delaware vs. Other Corporations

	Delaware Corps.				Other Corps.			
	Mean (SD)	25th	Median	75th	Mean (SD)	25th	Median	75th
Daily Returns[28]	0.0005 (0.047)	-0.015	0	0.014	0.0005 (0.038)	-0.012	0	0.012
Volume (thousands of shares)	1,643 (8,846)	95	331	1,109	1,062 (4,749)	34	184	733
Mrk Cap. (millions of USD)	9,780 (44,200)	253	1,110	4,410	9,650 (71,000)	206	828	3,730

C. Methods

We test the above hypotheses in three ways. First, we employ conventional event study methods to detect anomalous fluctuations in the prices of securities for Delaware-incorporated companies over time. These models aggregate across all treated firms—here, firms incorporated in Delaware on the event date—and utilize information regarding trends in these firms' securities prices during a pre-event estimation window, which is the most common approach to securities event studies (Corrado 2011).

Second, we examine the share-price fluctuation of each individual firm in our sample—both those incorporated in Delaware and elsewhere—on the date of the event. Specifically, we regress event-day market returns on whether a firm is Delaware-incorporated (along with other firm-level covariates). This approach allows for the modeling of firm-level features, which are absent in the first approach. The disadvantage of this approach relative to conventional securities event studies is that it offers an event-day snapshot, without accounting for trends in securities prices prior to the event.

Third, we model share-price fluctuation across the 100 trading days surrounding the event date. This approach allows us to observe differences in the market behavior of Delaware firms on the event date relative to both non-Delaware firms on the event date and Delaware firms on other trading days. Like the conventional securities event study methods of our first approach, this approach utilizes information on trading days other than the event date; like the event-day OLS

[28] Daily returns are defined as the change in share price between consecutive trading days. Dividends are reinvested on the ex-date, i.e., the date the security starts trading without the value of its next dividend payment (Center for Research in Security Prices 2021, p. 77).

regression models that we utilize in our second approach, this approach models firm-level features that are considered to influence share price.

This section describes each of these three methods in turn.

1. Event Study Analysis

As in conventional securities event studies, we first examine abnormal returns across all Delaware-incorporated firms. We start with a basic market model, which also known as the capital asset pricing model. For each covered stock i on event date t, we calculate expected returns r_{it}:

$$\hat{r}_{it} = \alpha + \beta_i \cdot (Mkt_t - Rf_t) + \varepsilon_{it} \qquad (1)$$

Where Mkt is the return of the market, Rf is the risk-free rate of return (based on a portfolio of short-term Treasury bills), and ε_{it} is an idiosyncratic component that captures firm-specific factors. Each firm's loadings on Mkt is estimated during the period between 120 and 30 trading days prior to the event date. Abnormal return for stock i on date t is therefore:

$$AR_{it} = \hat{r}_{it} - [\alpha + \beta_i \cdot Mkt_t - Rf_t)] \qquad (2)$$

And the cumulative abnormal return across all Delaware firms on the event date is:

$$AAR = \frac{1}{N}\sum_{i=1}^{N} AR_{i,t} \qquad (3)$$

We calculate AAR with a one-day event window.[29] Because the most relevant events in the *Adams* litigation occurred relatively early in the trading day,[30] it is reasonable to assume that market participants had sufficient time to acquire information and, if desired, react by trading on the highly active NYSE and NASDAQ exchanges. Further, it is exceedingly rare for the content of a judicial decision to become public before the decision is formally issued, lessening concerns about information leakage prior to the event date (Gerstein 2022; Davis et al. 2024).

Alongside the market model, we also employ the Fama-French three-factor model as an alternative specification. This specification adds to the market model two additional systematic risk factors that are thought to affect stock performance (Fama & French 1993). These factors are (1) the difference in returns between small- and large-cap stocks, which accounts for the tendency of the former to outperform the latter in the long-term, and (2) the difference in returns between

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[29] Given this one-day event window, cumulative average abnormal returns (CAARs) are equivalent to AAR here.

[30] Specifically, the district court's summary judgment grant was issued at 11:49 a.m. on December 6, 2017; email correspondence between the authors and Carney's counsel confirms that the Third Circuit released its opinion at February 15, 2019; the Supreme Court releases its cert grants at 9:30 a.m. and reads merits decisions starting at 10:00 a.m.; and the district court entered the proposed consent judgment ending the *Adams* litigation at 11:27 a.m. on January 30, 2023.

high book-to-market (or value) stocks and low book-to-market (or growth) stocks, which again captures the long-term tendency for the former to outperform the latter.[31]

The market and Fama-French models are widely adopted approaches for securities event studies. Each model possesses relative advantages and disadvantages vis-à-vis the others (Campbell et al. 2012). For instance, recent research has documented substantial and unexplained revisions in the data used for the Fama-French factors, especially the difference in returns between value and growth stocks (Akey, Robertson, and Simutin 2023). By contrast, the market-returns factor appears to be least affected by these issues. In other words, these potential issues may affect the market model much less than they affect the three-factor model (id.).

We also report results from a four-factor model, which adds stock-market momentum to the Fama-French specification, is also included. Following Carhart's (1997) finding of a medium-term momentum effect in stock returns, many securities event studies model this feature (e.g., Larcker et al. 2011). Finally, we report results from a raw returns model.

2. Event Day Regression Models

For another window onto these potential effects, we assess how the price effects of events relate to firm characteristics for a cross-section of firms. In other words, for all firms trading on the NYSE or NASDAQ on the event date—whether incorporated in Delaware or another state—we run ordinary least squares (OLS) regression of event-date returns on whether the firm was incorporated in Delaware plus a set of firm characteristics. This model takes the following form:

$$r_i = \alpha + \beta_1 Delaware_i + \beta_2 MrkValue_i + \beta_3 BookMrkRatio_i + \beta_4 Momentum_i + \gamma_{sector_i} + \varepsilon_i \quad (4)$$

where r_{it} is the change in firm i's closing price between trading day t-1 and t, measured as a percentage over/under the firm's closing price on t-1. Delaware is a dummy variable coded as 1 if the firm is incorporated in that state on the event date. *MrkValue* is the natural log of the firm's market value at the opening bell on the event date. *BookMrkRatio* is the firm's book value divided by its market value, with both measured at the end of the fiscal year immediately preceding the event. *Momentum* is the change in the firm's share price in the six months preceding the event date. Finally, some models include $\gamma_{industry_i}$, a set of 25 industry-level fixed effects, each

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[31] More precisely, this model modifies Equations (1) and (2) as follows:

$$\hat{r}_{it} = \alpha + \beta_{i,1} \cdot (Mkt_{it} - Rf_{it}) + \beta_{i,2} \cdot SMB_{it} + \beta_{i,3} \cdot MHL_{it} + \varepsilon_{it}$$

where r_{it} is the expected returns for stock i on date t, Mkt - Rf is the return of the market portfolio minus the risk-free rate of return, *SMB* is the return on small- minus large-cap stocks, and *HML* is the return on value stocks (high book-to-market ratio) minus growth stocks (low book-to-market ratio). Abnormal return for stock i on date t is therefore:

$$AR_{it} = \hat{r}_{it} - [\alpha + \beta_{i,1} \cdot (Mkt_t - Rf_t) + \beta_{i,2} \cdot SMB_t + \beta_{i,3} \cdot HML_t]$$

corresponding to a GICS industry group and coded as a 1 if Standard & Poor's classifies the firm as operating primarily in that industry.[32]

3. Pooled Regression Models

Finally, we run regression models pooling across firm-days during the period beginning 50 trading days before the event and ending 50 trading days after it. The first of these models takes the following form:

$$r_{it} = \alpha + \beta_1 Delaware_i * EventDay + \beta_2 Delaware_i + \beta_3 EventDate + \beta_4 MrkValue_i + \beta_5 BookMrkRatio_i + \beta_6 Momentum_i + \gamma_{sector_i} + \varepsilon_i \quad (5)$$

This model builds on Equation (4), adding an *EventDay* dummy covariate coded as a 1 if the firm-day observation occurs on the date of the event and an interaction between this covariate and the *Delaware* covariate; this interaction term is coded as a 1 if the firm-day observation is a Delaware-incorporated firm on the event date. Thus, the coefficient estimate β_1 for this interaction term tests whether the relationship between Delaware incorporation and returns changes based on whether the observation occurred on the event date.

II. Analysis

This section reports our results. In brief, we find negative abnormal returns accompanying the district court's decision in most models, supporting Hypothesis 1, and positive abnormal returns across all models on the date that the Supreme Court issued its opinion, which supports Hypothesis 2.

A. Event Study Analysis

1. District Court Decision

Table 2 reports the results of the aggregate-level event studies for the date on which the district court granted summary judgment to Adams. Recall that we expect the market to react negatively to the court's invalidation of partisan balance requirements for the Delaware judiciary, and thus hypothesize that shares of Delaware-incorporated firms will trade at a discount on the date on which the decision was issued.

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[32] For other cross-sectional analyses of event-day returns using *MrkValue*, *BookMrkRatio*, and *Momentum* as control variables, see, e.g., Larcker et al. (2017). For discussion of advantages of using these four-digit GICS codes over their alternatives as fixed effects, see Amihud & Stoyanov (2017).

Table 2: Abnormal Returns on Date of District Court Decision

Specification	Avg. Abn. Return (AAR)	t-statistic
Market Model	-0.0064 ***	-9.4531
Fama-French 3-Factor Model	-0.0032 ***	-4.7905
Fama-French + Momentum	-0.0030 ***	-4.4932
Raw Returns Model	-0.0077 ***	-11.0585

Table presents estimates for the market reaction to district court's 12/6/2017 grant of summary judgment to plaintiff in *Carney v. Adams*, thus invalidating Delaware courts' partisan-balance requirements. Observations: 2,149 NYSE- or NASDAQ-traded firms incorporated in Delaware on the event date. *** signifies $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

As the table shows, the average abnormal returns to Delaware firms are negative and statistically significant across all model specifications. For instance, the market model reports average abnormal returns (AAR) of -0.64 percentage points across Delaware-incorporated firms on the event date. The estimates from the multi-factor models are roughly half the size, but still not trivial, considering that the median NYSE- or NASDAQ-traded security witnessed movement of 0.99 percentage points (in absolute terms) on that date.

In unreported analyses, we re-run the models in Table 2 excluding stocks that trade at less than $1 per share and, separately, excluding firms with a market capitalization under $10 million. We exclude these penny stocks and, separately, micro-cap firms because Amihud and Stoyanov (2017) find differential value effects of court rulings concerning corporate governance on firms with these characteristics versus other firms. These models produce directionally consistent and statistically significant AAR estimates as well.

We also examine how event-date performance of Delaware firms compares to the performance of firms incorporated elsewhere. Figure 1 reproduces the AAR estimates for Delaware firms from in Table 2 alongside the same estimates for non-Delaware firms. As the negative estimates for the raw returns model show, NYSE- and NASDAQ-traded stocks performed poorly overall on the day of the district court's decision. Notably, however, Delaware firms performed worse than non-Delaware firms on that date, with these differences in abnormal returns achieving conventional levels of statistical significance across all model specifications. In addition, whereas the AAR estimates for Delaware firms are consistently negative across all models, the estimates for non-Delaware firms are slightly positive in both multi-factor models.

Figure 1: Abnormal Returns for Delaware vs. Other Firms on District Court Decision Date

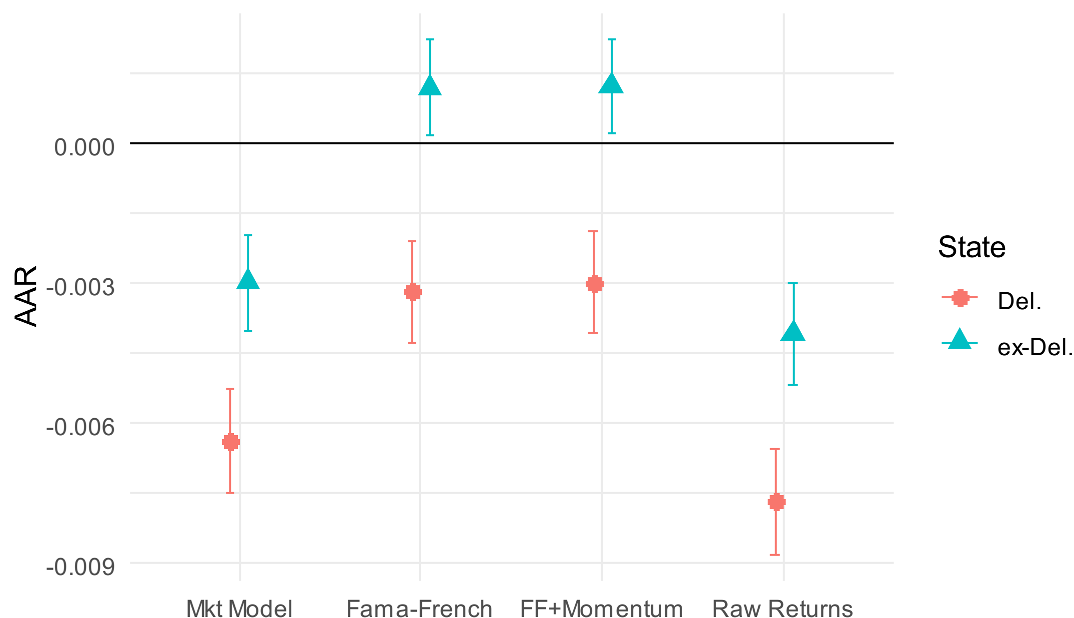

Figure presents estimates for the market reaction to district court's 12/6/2017 invalidation of Delaware courts' partisan-balance requirements. Circles denote AAR estimates for Delaware-incorporated firms (n = 2,149). Triangles denote estimates for firms incorporated in other states (n = 1,177). Bars signify 90 percent confidence intervals.

Finally, we examine abnormal returns by firm size. These results are reported in Appendix A. In brief, the negative AAR estimates for Delaware firms are most pronounced for small-cap firms.[33] We reflect on the implications of these results by firm size in Section III.

2. Supreme Court Decision

Turning to the other major event in the *Adams* litigation, Table 3 displays AAR estimates for Delaware firms on the date on which the Supreme Court vacated the lower courts' judgment. Here, recall that we expect Delaware firms to experience a positive price effect on the news, per Hypothesis 2.

[33] That effect size gradually approaches zero—albeit not monotonically—as one moves from the lowest quintile of firms by market capitalization to the highest quintile. Further, for most quintiles, the 90% confidence intervals around the AAR estimates for Delaware versus non-Delaware firms overlap, thus limiting inferences; only for mid-cap firms does the difference in AAR estimates for Delaware versus non-Delaware firms achieve conventionally accepted levels of statistical significance.

Table 3: Abnormal Returns on Date of Supreme Court Decision

Specification	AAR	t-statistic
Market Model	0.0113 ***	13.3595
Fama-French 3-Factor Model	0.0028 ***	3.4805
Fama-French + Momentum	0.0028 ***	3.4973
Raw Returns Model	0.0128 ***	14.3737

Table presents estimates for the market reaction to U.S. Supreme Court's 12/10/2020 vacating the judgment in *Carney v. Adams*, thus preserving Delaware courts' partisan-balance requirements for the time. Observations: 2,310 NYSE- or NASDAQ-traded firms incorporated in Delaware on the event date. *** signifies $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

The positive, statistically significant AAR estimates across all model specifications in Table 3 support Hypothesis 2. For instance, the market model estimates a 1.13 percentage point abnormal return for Delaware firms. This abnormal increase more than cancels out the abnormal decrease associated with the district court's decision. Similarly, the positive AAR estimates in the multi-factor models nearly cancel out the negative abnormal returns on the date of the district court's decision. Once again, model specification that exclude penny stocks and, in separate models, companies with market capitalizations below $10 million produce consistent results.

Figure 2 compares Delaware firms' abnormal returns on the date of the Supreme Court's decision to those of firms incorporated in other states. Across all models, Delaware firms experienced higher abnormal returns than did companies incorporated in other states. Further, whereas the AAR estimates are consistently positive for Delaware firms across all models, the directionality of these estimates is model-dependent for firms incorporated elsewhere, with negative estimates for non-Delaware firms in both multi-factor models.

Figure 2: Abnormal Returns for Delaware vs. Other Firms on Supreme Court Decision Date

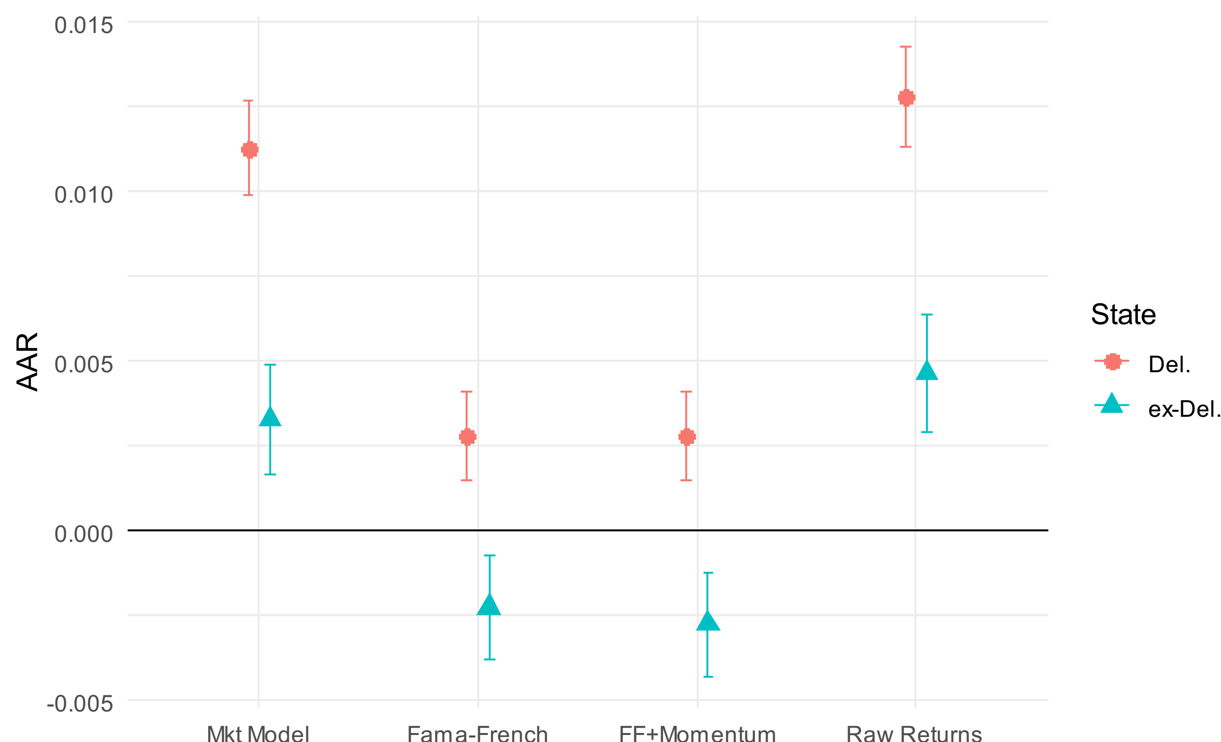

Figure presents estimates for the market reaction to Supreme Court's 12/10/2020 vacatur of the district court's judgment. Circles denote AAR estimates for Delaware-incorporated firms (*n* = 2,310). Triangles denote estimates for firms incorporated in other states (*n* = 1,225). Bars signify 90 percent confidence intervals.

As before, Appendix A reports abnormal returns by firm size quintile. Here, both of the principal models—the market model and Fama-French model—show that the positive abnormal returns that Delaware experienced on the date of the Supreme Court's decision are concentrated among smaller public firms.

3. Other Events

We also presents results from event study models for the six additional events discussed in the hypotheses section: (1) the district court's denial of Carney's motion for reconsideration; (2) the circuit court's affirmance; (3) the circuit court's denial of Carney's petition for rehearing en banc; (4) the Supreme Court's grant of Carney's cert petition; (5) oral argument in the Supreme Court; and (6) the parties' settlement of subsequent litigation. Table 4 reports average abnormal return estimates for these six events using two common model specifications, the market model and the Fama-French three-factor model.

Table 4: Abnormal Returns on Dates of Other Events in the *Adams* Litigation

Event	Prediction	Market Model		3-Factor Model	
		AAR	t-stat.	AAR	t-stat.
District court denial of reconsideration motion	negative	-0.0010	-1.4059	-0.0018 **	-2.5537
Circuit court affirmance	negative	-0.0005	-0.6770	-0.0001	0.8722
Circuit court's denial of petition for rehearing en banc	conflicting	0.0020 **	2.4978	0.0022 ***	2.7867
Supreme Court cert grant	positive	0.0024 ***	3.1623	0.0003	0.3675
Supreme Court oral argument	conflicting	-0.0015	-1.4629	-0.0030 ***	-3.1612
Settlement	conflicting	0.0011	1.3627	-0.0013	-1.6259

Table presents estimates for the market reaction to the following events: (1) the district court's 5/23/2018 denial of Carney's motion for reconsideration, thus preserving its invalidation of Delaware courts' partisan-balance requirements; (2) the Third Circuit's 2/5/2019 affirmance of the district court's grant of summary judgment; (3) the Third Circuit's 5/7/2019 denial of Carney's petition for rehearing before the court en banc; (4) the Supreme Court's 12/6/2019 grant of Carney's petition for writ of certiorari; (5) oral argument before the Supreme Court on 10/5/2020; and (6) the parties' stipulated consent judgment and order on 1/30/2023. Observations: NYSE- or NASDAQ-traded firms incorporated in Delaware on the event date *** signifies $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

Concerning the denial of Carney's motion for reconsideration, both models yield negative AAR estimates, with the estimate reaching conventionally accepted levels of statistical significance in the Fama-French model. This result is as expected, because the denial reinforces the district court's earlier decision that was adverse to Delaware and in effect closed the first of several options to reverse this decision. Notably, the AAR estimates are much smaller for this event than they are for the district court's decision reported in Table 2. That is sensible, as one could imagine that the court declining to reconsider its earlier decision would shift investors' priors less than the court's initial decision did.

By contrast, we find little evidence that the circuit court's affirmance moved markets. Recall that, because this appellate decision presumably provided greater certainty that the district court's judgment would stand, we expected this news to trigger a relative decline in share price for Delaware-incorporated firms vis-à-vis firms incorporated in other states. Although the estimates in the table are negative, they do not approach statistical significance.

Due to potentially conflicting considerations, we do not offer a prediction regarding the denial of Carney's petition for rehearing en banc. As the table shows, the AAR estimates are positive and statistically significant in both models. These results suggest that the Third Circuit's

10-4 split, with several prominent judges favoring rehearing, may have signaled to the Supreme Court, and therefore also to investors, that a strong cert petition was on the way.[34]

For the Supreme Court's grant of Carney's cert petition, one of the two models yields a positive and statistically significant estimate. The market model estimate provides support for the notion that investors interpreted the grant as increasing the likelihood that Delaware's judicial partisan-balance requirements would survive, though that support is qualified by the null result in the Fama-French specification. Similarly, one of the two models reports a statistically significant coefficient for oral argument, suggesting that investors may have (wrongly) interpreted oral argument as signaling that the Court would affirm. Once again, we offer this interpretation with caution in light of the null result in the other model.

Finally, for the date of settlement, the conflicting directionality and lack of significance in the models preclude any inferences.

B. Event Day Regression Models

Turning to cross-sectional analysis, we first regress each public company's event-day returns on whether that company is incorporated in Delaware and a battery of control variables. Table 5 reports these results for the date of the district court decision (Models 1 and 2) and the Supreme Court decision (Models 3 and 4).

[34] The denial of the petition for rehearing en banc also coincided with the *Wall Street Journal*'s publication of its first poll of Democratic primary voters after Joe Biden's entry into the 2020 presidential race. The poll showed Biden—a longtime U.S. senator from Delaware—with an early advantage over rivals such as Senators Bernie Sanders and Elizabeth Warren (Zitner 2019). Given Biden's long track record of defending Delaware interests against congressional efforts to federalize corporate charters (Blumenthal 2019), positive news regarding Biden's campaign may have contributed to the price increase for Delaware-incorporated firms on that date.

Table 5: Regressing Event Day Returns on Delaware Incorporation and Other Firm-Level Features

Event	District Court Decision		Supreme Court Decision	
	(1)	(2)	(3)	(4)
Delaware Incorporation	-0.0041 ** (0.0012)	-0.0025 (0.0017)	0.0084 *** (0.0015)	0.0030 ** (0.0014)
Market Value	Y	Y	Y	Y
Book-to-Mkt Ratio	Y	Y	Y	Y
Momentum	Y	Y	Y	Y
Sector FEs	N	Y	N	Y
F	9.26 ***	9.01 ***	12.27 ***	11.41 ***
n	3,069	3,064	3,177	3,134

Dependent variable: change in returns on the event date versus the prior trading date. Unit of analysis: Each public corporation *i* whose stock trades daily on the NYSE or NASDAQ throughout the period beginning 120 trading days prior to the event date and ending on the event date *t*. Model: OLS. *Delaware*: coded 1 if *i* was incorporated in Delaware on *t*. *Market Value*: natural log of the *i*'s market capitalization at the beginning of trading day *t*, in millions of dollars. *Book-to-Market Value*: *i*'s book value divided by its market value at the end of the fiscal year prior to *t*. *Momentum*: (*i*'s opening price on *t* – *i*'s opening price six months prior to *t*) / (*i*'s opening price six months prior to *t*). *Sector fixed effects* are a set of 25 dummy variables corresponding to GICS industry group. Robust standard errors appear in parentheses, and are clustered at the sector level in Models 2 and 4. F-statistics calculated via models without clustered standard errors. *** signifies $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

The table reports mixed results concerning the district court decision. Model 1, which does not include sector-level fixed effects, features a negative and statistically significant coefficient estimate for the price effect of Delaware incorporation (*Delaware*). This result supports Hypothesis 1. When we include sector fixed effects in Model 2, however, our coefficient estimate—though still directionally in line with Hypothesis 1—falls short of conventional statistical-significance thresholds.

The results concerning the Supreme Court decision are more consistent. Models 3 and 4 both report positive abnormal returns for Delaware firms on the date on which the Supreme Court vacated the lower courts' judgment. These results support Hypothesis 2.

To further probe the strength of these findings concerning Hypothesis 2, Appendix B contains additional tests of this hypothesis. First, we re-run Model 2 in Table 5 for each of the ten trading days on either side of the event date. Plotting the coefficient estimates for *Delaware* across this [-10, +10] trading day window reveals that the positive and statistically significant abnormal returns that Delaware firms experienced on the date on which the Supreme Court issued its opinion were unusual. This plot also shows an absence of any pre-trend in the period leading up to this event date. We then calculate coefficient estimates and a measure of statistical significance for *Delaware* over the [-50, +50] trading day period. Plotting these figures confirms that Delaware

firms' market behavior on this event date was unusual, both in the magnitude of abnormal returns and the level of statistical significance.

C. Pooled Multi-Day Regression Models

Our next set of models pools across firm-days during the 100 trading days surrounding each event date. Specifically, for each firm-day in our sample, we regress daily returns on whether the firm is incorporated in Delaware, whether the day of the observation is the event date, an interaction of these two terms, and firm-level features introduced above.

Table 6 reports the results. The first column runs the model for the 50 trading days on either side of the district court's decision. The second column runs the model for the 50-trading-day period around the Supreme Court's decision.

Table 6:
Price Movement for Delaware vs. Other Firms, on the Event Date vs. Other Trading Days

Event	District Court Decision	Supreme Court Decision
	(1)	(2)
*Event Date * Delaware Incorporation*	-0.0036 *** (0.0011)	0.0078 *** (0.0013)
Event Date	-0.0046 *** (0.0009)	0.0001 (0.0009)
Delaware Incorporation	-0.0041 (0.0040)	-0.0098 (0.0068)
Market Value	Y	Y
Book-to-Mkt Ratio	Y	Y
Momentum	Y	Y
Firm FEs	Y	Y
F	1.38 ***	2.19 ***
n	289,501	298,440

Dependent variable: daily change in raw returns. Unit of analysis: Measured at the firm-trading day level; includes all public corporations whose stock trades on the NYSE or NASDAQ on during the period beginning 50 trading days prior to the event and ending 50 trading days after it. Model: OLS. *Delaware*: coded 1 if *i* was incorporated in Delaware on the observation's date. *Event Date*: coded 1 if the observation occurred on the date of the event. *Market Value*: natural log of the *i*'s market capitalization at the beginning of trading day *t*, in millions of dollars. *Book-to-Market Value*: *i*'s book value at the end of the fiscal year prior to *t* divided by its market value. *Momentum*: given by the formula *i*'s opening price on *t* minus *i*'s opening price six months prior to *t* divided by *i*'s opening price six months prior to *t*. *Firm fixed effects* are a set of dummy variables corresponding to each stock that appears in our sample on at least one trading day during the [-50, +50] trading day period around the relevant event. There are 4132 firm fixed effects in Model 1 and 4104 in Model 2. Robust standard errors appear in parentheses, and are clustered at the sector level in Models 2 and 4. F-statistics calculated via models without clustered standard errors. *** signifies $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

Once again, these results support our hypotheses. For the district court decision, the coefficient estimates for the *Event Date*Delaware* interaction term reported in Panel (a) are negative and statistically significant. With respect to the Supreme Court's decision, the positive and statistically significant estimates for the *Event Date*Delaware* interaction terms in Panel (b) indicate that Delaware firms received a boost on the day that the high court vacated the judgment for Adams, relative to non-Delaware firms on that date and to Delaware firms on other dates.

III. IMPLICATIONS

A. Interpreting the Results

Our results are broadly consistent with the claim that Delaware's constitutional commitment to a politically balanced judiciary adds value to firms incorporated in the state. In all, six of the seven model specifications yield a negative and statistically significant abnormal return for Delaware firms on the date of the district court's decision striking down Delaware's partisan balance regime. On the date that the Supreme Court restored Delaware's partisan balance regime, all seven models produce a positive and statistically significant abnormal return.[35]

The effect sizes of these events are not trivial. Table 2 reports that Delaware firms experienced a negative abnormal return of approximately 0.3 to 0.6 percentage points on the date of the district court's decision; Table 3 reports a positive abnormal return of 0.3 to 1.1 percentage points corresponding to the Supreme Court's decision. By comparison, the average annualized return of the S&P 500 is approximately 10 percent over the previous 25 years (Robertson 2023). A difference of 0.3 to 1.1 percent in firm value—though not enormous—is still meaningful over a short time horizon.

Notably, however, the one model for the district court event that does not yield statistically significant results is the event-day model that includes sector fixed effects (see Model 2 in Table 5). That is an important limitation that compels us to interpret our results cautiously with respect to the district court opinion. Consider that the sectoral composition of Delaware corporations differs from that of the other states in several respects: for example, energy, health care, financial services, and information technology are overrepresented, while real estate and utilities are underrepresented among Delaware charters (CRSP 2024). It follows that a sector-specific event occurring on the same day as an event in the *Adams* litigation could bias our results.

Nonetheless, one should not place undue weight on the null results in the model with sector fixed effects, as the inclusion of sector-specific information is not necessarily the optimal modeling choice. On the one hand, ignoring sectoral differences between Delaware-incorporated and other firms raises the prospect of sector-specific developments on the event date biasing our results. On the other hand, the fact that companies in different sectors have differing propensities to incorporate in Delaware may itself be informative. For instance, if firms in one sector tend to be at heightened risk of derivative suits—say, because their business is particularly high-profile, high-risk, complex, or controversial—firms in that sector may place greater value on Delaware's judiciary. These firms therefore would be more likely to incorporate in Delaware than would firms in other sectors. If this account is accurate, then inclusion of sector fixed effects may introduce a confounding variable—call it "the value of 'the Delaware way' to the company"—that bears on

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[35] The seven models are the four in Tables 2 and 3, the two event-day regression specifications in Table 5, and the pooled multi-day regression specification in Table 6.

both share price on event dates (the dependent variable) and the sector fixed effects (an independent variable).

On the date of the Supreme Court's decision, the results are even clearer. Every model indicates that investors appear to have reacted positively to the Supreme Court's ruling, which restored Delaware's partisan balance regime. The results in Appendix B, which compare securities returns on the event date to returns on nearby trading days, confirm that the positive and statistically significant abnormal returns on that event date are outliers.

It is not surprising that the Supreme Court's message to trading markets was stronger than the message from the district court. Investors are more likely to focus their attention on a much-anticipated Supreme Court ruling than a district court decision in a case that had generated little prior press coverage. Moreover, if some market participants viewed the lower courts' decisions as mere placeholders until the Supreme Court weighs in, those investors should be expected to react more decisively to the Supreme Court's decision than to placeholder decisions along the way. To be sure, the Supreme Court did not offer a final resolution; its vacatur for lack of standing did not reach the merits of Adams's complaint. Still, the Supreme Court's decision signaled that Delaware's partisan balance regime would remain substantially intact for at least as long as it would take for a proper plaintiff to establish standing and obtain a second injunction.

Finally, we offer a word on other events in the *Adams* litigation, apart from the status quo-disrupting district court and Supreme Court decisions. The results for these other dates tend to be smaller in magnitude and not always statistically significant. Nonetheless, on the dates for which we can derive clear predictions regarding the *Adams* litigation's impact, our estimates are all directionally consistent with the hypothesis that positive developments for the defendant governor in *Adams* generated positive effects on the share prices of Delaware-incorporated firms.

B. Implications for Partisan Balance Requirements

Our results shed new light on the value of partisan balance requirements in the judicial context. The negative abnormal returns for Delaware firms on the day the partisan balance regime was struck down and the positive abnormal returns for Delaware firms on the day the regime was restored both suggest that investors believe that partisan balance on the state judiciary benefits Delaware corporations. To be sure, studies such as ours that examine abnormal returns in securities markets over a short window reflect only market expectations, not long-term outcomes. Moreover, studies such as ours cannot distinguish between investors' rational versus irrational responses to new information (Fisch, Gelbach, and Klick 2018). Still, our results indicate that investors—who have strong financial incentives to trade on their informed views—believe that partisan balance is a boon to Delaware companies.

Importantly, stock market prices reflect only the view of one corporate constituency: shareholders. What we call "the market value of partisan balance" does not include any value—positive or negative—that employees, customers, creditors, or other stakeholders assign to a politically balanced judiciary. Although this is no doubt a limitation of our event-study approach, the limitation is potentially less serious in the present context because of the particular mix of cases

that Delaware state courts hear. Employment-related claims and consumer class actions against Delaware-chartered firms are typically litigated elsewhere—either in federal court or in other state courts. And while a Delaware charter would enable a firm to file a bankruptcy petition in Delaware (28 U.S.C. § 1408), bankruptcy petitions go to federal bankruptcy court, not state court. Delaware courts, by contrast, are more likely to hear cases that pit shareholders against management or targets against acquirers. Although these cases still may affect non-shareholder constituencies (e.g., workers who might be laid off if a merger goes through), our concern about our failure to measure the reactions of non-shareholders is less acute than if the Delaware courts had wider jurisdiction over Delaware-incorporated firms that conduct much of their business elsewhere.

Why do investors value Delaware's partisan balance regime? First, as noted above, partisan balance requirements may exert a moderating effect on the judiciary in what is otherwise a single party-dominated state. Second, Delaware's partisan balance regime may enhance the quality of judicial decisionmaking by ensuring that the state's five-member supreme court represents a wider range of perspectives. Third, partisan balance may increase the likelihood of one or more justices "blowing the whistle" if the state supreme court majority issues a decision that threatens corporate interests. Perhaps the most famous example of this phenomenon in Delaware history is the 1985 case of *Smith v. Van Gorkom*—issued over two dissents—which held that directors of the company TransUnion had breached the duty of care by approving a merger without adequately informing themselves as to the company's intrinsic value.[36] Following those whistleblowing dissents, the Delaware General Assembly responded by enacting liability-shield legislation that substantially limited the fallout from *Van Gorkom*. As Skeel (1997, p. 170 n.322) notes, dissents such as those in *Van Gorkom* have a particularly "powerful signaling effect" given the "norm of unanimity" that generally governs Delaware Supreme Court decisionmaking. Note, though, that these last two rationales—panel diversity and whistleblowing—apply primarily to the Delaware Supreme Court, not the Delaware Court of Chancery, where the chancellor and vice chancellors hear cases individually rather than on panels.

Finally, our results provide suggestive evidence that partisan balance regimes can advance their intended objective even without an other-major-party reservation to backstop a bare-majority limitation. Our point estimates for the final event date in *Adams*—the settlement that preserved the bare-majority limitation but eliminated the other-major-party reservation—are inconsistently signed and do not achieve conventionally accepted levels of statistical significance (see Table 4). Whereas investors responded negatively to the district court's invalidation of the entire partisan balance regime, we cannot reject the null hypothesis that investors were unbothered by the settlement agreement eliminating only the other-major-party reservation. This nonplussed reaction is consistent with the evidence in Nagel and Lubin (1964), Gormley (1979), Ho (2007), and Feinstein and Hemel (2008) indicating that bare-majority limitations meaningfully affect the ideological composition of multimember bodies even in the absence of other-major-party reservations. It also suggests that investors disagree with the claim by the Third Circuit panel in *Adams* that Delaware's bare-majority limitation and other-major-party reservation are "equally

[36] 488 A.2d 858 (Del. 1985).

integral" to the state's partisan balance regime.[37] At least from the perspective of equity market investors, the presence or absence of a bare-majority limitation appears to be much more important than the presence or absence of an other-major-party reservation.

C. Implications for Delaware's Dominance

In addition to their implications for the debate over partisan balance requirements, our results inform scholarship on the "Delaware effect" in corporate law. First, our results lend support to the view that unique features of the state's legal landscape add value to Delaware-incorporated firms. Second, our results suggest that one particular feature of that landscape—the state's constitutional commitment to a politically balanced judiciary—accounts for a nontrivial component of the value of a Delaware charter.

As noted, scholars have sought to estimate the effect of a Delaware charter on shareholder wealth by measuring market responses to reincorporation choices, but because reincorporation choices are endogenous to corporate strategy, these studies struggle to distinguish between causation and non-causal correlation. Our study is to our knowledge the first to explore how an exogenous change to a structural feature of Delaware law affects shareholder wealth. Other important state-level attributes—for example, Delaware's small size—are unlikely to change on a dime. By contrast, the December 2017 district court decision striking down Delaware's partisan balance regime was a sudden and significant shock to the Delaware legal system.

The fact that markets responded in the predicted direction to both the district court's December 2017 decision and the Supreme Court's December 2020 restoration of Delaware's partisan balance regime suggests that investors assign positive value to at least one structural feature of Delaware law. These results pose a challenge to claims by "Delaware effect" skeptics that market actors are indifferent to a firm's state of incorporation. For example, Rhee (2022, p. 300) argues that "[m]arket actors do not behave as if Delaware law matters to firm value." Our results indicate that at least one feature of the Delaware legal landscape does matter to equity market investors.

Going further, the concentration of abnormal returns among smaller firms on the two major event dates supports the "credible commitment theory" of Delaware's dominance in the market for corporate charters. Recall that this theory posits that firms seek to incorporate in states that precommit to being responsive to those firms' needs (Romano 1985). A constitutional requirement of partisan balance on state courts is one mechanism by which Delaware can precommit to stable and bipartisan corporate law doctrine (Eldar and Rauterberg 2023). According to the credible commitment theory, investors value durable measures because firms' switching costs into a new state of incorporation are nontrivial (Romano 1985). If it were costless for firms to reincorporate, investors would not value measures like partisan balance requirements because firms could easily decamp for a friendlier jurisdiction should Delaware law take a turn that they oppose. In reality, however, switching costs can be substantial (Sanga 2020, p. 10). For instance, a firm desiring to reincorporate in another state must undertake a proxy campaign to convince shareholders to

[37] Adams v. Governor of Delaware, 922 F.3d 166, 184 (3d Cir. 2019).

approve the reincorporation and educate its corporate officers and directors on their responsibilities under a different body of corporate law. With larger firms benefiting from economies of scale, switching costs are a relatively greater burden on smaller firms (Bebchuk and Cohen 2002). It follows that smaller firms will value precommitment mechanisms like partisan balance requirements more than larger firms. Thus, the concentration of event-date abnormal returns among smaller firms is consistent with the credible commitment theory of Delaware's dominance, as these firms are more sensitive to switching costs and thus place greater value on precommitment devices like partisan balance requirements.

Our results regarding the relationship between firm size and the market value of partisan balance take on particular relevance in the wake of the high-profile decision by the electric carmaker Tesla to relinquish its Delaware charter in 2024. Tesla was, at the end of 2023, the seventh largest corporation by market capitalization traded on a U.S. securities exchange (Tesla 2024, p. 74). For a firm of Tesla's size, the transaction costs of reincorporation were small relative to a total equity value of approximately $800 billion. Thus the credible commitment theory would suggest that the value of a Delaware charter is smaller—at least as a percentage of firm value—for Tesla than for most other publicly traded companies. Notably, Texas, where Tesla is now chartered, has tried to replicate the corporate law expertise of the Delaware judiciary by creating its own business court to hear complex commercial cases (Vipers, Felton, and Otis 2024). Texas has not, however, adopted partisan balance requirements for its business court or for other arms of its state judiciary. Our results suggest that smaller firms—for whom the switching costs of reincorporation amount to a larger percentage of equity value—may be reluctant to follow Tesla's move to a state that lacks a constitutional commitment to partisan balance on its courts.

Our results also shed light on the *composition* of the Delaware effect—and, specifically, how much of the Delaware effect can be attributed to the state's constitutional commitment to a politically balanced judiciary. As we reported, Delaware firms experienced a decline in value of approximately 0.3 to 0.6 percentage points, depending on the model, on the date of the district court's invalidation of the state's partisan balance requirements (Table 2). The Supreme Court's vacatur of that decision sparked roughly the reverse effect: a 0.3 to 1.1 percentage point increase in firm value, again depending on the model (Table 3). By comparison, the weighted average of the six studies highlighted in Bebchuk, Cohen, and Ferrell (2002) indicated an abnormal return associated with reincorporation in Delaware of approximately 1.2 percentage points. Viewed against that comparator, the value of partisan balance appears to be substantial. Even taking the low end of the range of estimates for our two key event dates, Delaware's partisan balance regime accounts for roughly one quarter of the value of a Delaware charter.

In addition to the implications for scholarship, quantifying this effect size may be particularly informative for three audiences: Delaware voters, federal policymakers, and potentially federal courts. Concerning the former group, consider that partisan balance requirements limit Delawareans' democratic control over their judiciary to an extent unseen elsewhere in the United States. Whereas voters in other states may influence and hold accountable their courts either directly through judicial elections or indirectly by electing the governors who appoint judges, Delawareans have tied their governor's hands, limiting his or her choice set.

Partisan balance requirements presumably also pull Delaware courts substantially to the right of Delaware's Democratic-leaning electorate.

In light of those accountability-diminishing and rightward-tilting effects, Delawareans may ask whether partisan balance requirements are worth it. One response might be that firms value these requirements, that therefore the provisions contribute to Delaware's dominance in the market for corporate charters, and that this dominance in turn fills state coffers. This response—which would have been pure conjecture before—now has a quantitative foundation, albeit with some limitations and qualifiers.[38]

The second audience is federal policymakers. Over the past two decades, landmark federal statutes such as the Sarbanes-Oxley Act of 2002 and Dodd-Frank Act of 2010 have intruded on the historically state-level regulation of corporate governance (Elson 2018). Today, some political leaders propose federalizing corporate law to an even greater extent. For instance, Senator Elizabeth Warren has proposed an Accountable Capitalism Act, which would require most public companies to obtain a federal charter and subject at least 40 percent of their board seats to employee elections (Eldar and Rauterberg 2023). Senator Bernie Sanders similarly calls for all publicly traded companies to obtain a federal charter that would require their board to take into account the interests of all corporate stakeholders, among other proposed requirements (Kahan 2021). A proposed new bureau within the Commerce Department would issue and monitor these federal charters.

In some instances, the federalization of corporate governance shifts authority from states to the Securities and Exchange Commission. Although the SEC is itself subject to a partisan balance requirement, this requirement does not encumber the President's selection of which of the five SEC commissioners serves as chair. Given the chair's agenda-setting power and control over commission staff to whom the commission subdelegates substantial authority (Feinstein & Zaring 2024), as a functional matter partisan balance requirements arguably are less consequential at the SEC than the Delaware judiciary. Further, the Commerce Department bureau that Senator Sanders proposes would not have a partisan balance feature at all. Our results suggest that investors prefer for corporate governance matters to be resolved by a politically balanced body. To be sure, the impact of a proposal on corporate valuations certainly is not the only factor at issue in evaluating proposed legislation, and investors are not the only relevant corporate constituency. Nonetheless, the fact that investors, by their revealed preferences, value adjudicative bodies with partisan balance requirements may be a factor worth considering.

[38] Our results also potentially inform efforts by other states to lure corporate charters away from Delaware. Along with the Texas example discussed above, Wyoming—which has a population roughly half the size of Delaware's—launched a campaign in 2019 to become the "Delaware of the West," establishing a new business-focused court designed to emulate the Delaware Chancery Court (Beyoud 2019; Matera 2022). Our findings suggest that unless another state adopts a constitutional partisan balance regime, it will not be able to match all the structural features of the Delaware judiciary that market actors find attractive. Although Delaware's sustained ability to dominate the market for corporate charters is likely multicausal and overdetermined, judicial partisan balance requirements in its state constitution appear to be a part of the mix.

Finally, these results could be useful to federal courts in the future. It is conceivable that a future litigant could challenge the constitutionality of Delaware's bare-majority provision, which remains in effect following the parties' settlement. After all, once a bare majority of seats on a given Delaware court has been filled by members of one political party, other members of that party cannot be considered for vacancies on that court. In effect, that requirement compels prospective judges who are members of the majority party to leave that organization, while not requiring the same of prospective judges who are members of other parties.

That effect arguably burdens these prospective judges' freedom of association under the First Amendment. In evaluating whether a state actor can condition public employment on party affiliation, the Supreme Court held in the 1980 case *Branti v. Finkel* that "the question is whether the hiring authority can demonstrate that party affiliation is an appropriate requirement for the effective performance of the public office involved."[39] Delaware might argue that for its judges, one element of "effective performance" is sustaining the state's corporate law "product," and partisan balance is an important feature of that product. Whether that argument ultimately carries the day in court remains to be seen. Still, our results suggest that the argument—successful or not—rests on a solid evidentiary foundation.

CONCLUSION

Promoters of partisan balance requirements argue that these provisions exert a moderating influence on decisionmakers, improve the quality of outcomes, and enable dissenting members to "blow the whistle" when their colleagues stray from the wishes of the legislature. In Delaware, the state's political leaders consider judicial partisan balance requirements to be a contributing factor to their courts' reputation in corporate law. That reputation, they contend, provides the state with a substantial competitive advantage in the market for corporate charters.

This study put those claims to the test. Its identification strategy leveraged the *Adams* litigation, a years-long challenge to the constitutionality of Delaware courts' partisan balance requirements. We examined whether events in *Adams* that increased the likelihood that the provisions would be struck down (upheld) were associated with abnormal negative (positive) returns to the stock of Delaware-incorporated public companies. Essentially, the theory here is that abnormal market fluctuations around these events reveal investors' views of the value of partisan balance on Delaware courts. We found that the events in the litigation that most disrupted the status quo—i.e., a district court decision invalidating the provisions and a Supreme Court opinion restoring the state's partisan balance regime—moved markets in the expected directions. Abnormal returns around these events are nontrivial and achieve conventionally accepted levels of statistical significance in a wide variety of model specifications. For investors, partisan balance requirements appear to be an important element of "the Delaware way."

[39] Branti v. Finkel, 445 U.S. 507, 518 (1980).

Appendices

This section contains two sets of additional analyses. Appendix A reports results of event study models run separately based on firm size. Appendix B reports results of additional tests to further assess the strongest result uncovered in this manuscript: that Delaware firms experienced abnormal returns on the date of the Supreme Court's decision.

Appendix A: Abnormal Returns by Firm Size

Figures A.1 and A.2 report AAR estimate for companies incorporated in Delaware versus those incorporated in other states broken out by firm size. Figure A.1 reports these estimates on the date of the district court decision. Recall that Hypothesis 1 predicts negative abnormal returns for Delaware firms on that date. Figure A.2 conveys similar information on the date of the Supreme Court's decision. Per Hypothesis 2, we expect positive abnormal returns for Delaware firms here.

Figure A.1: Abnormal Returns for Delaware vs. Other Firms on District Court Decision Date, by Firm Size Quintile

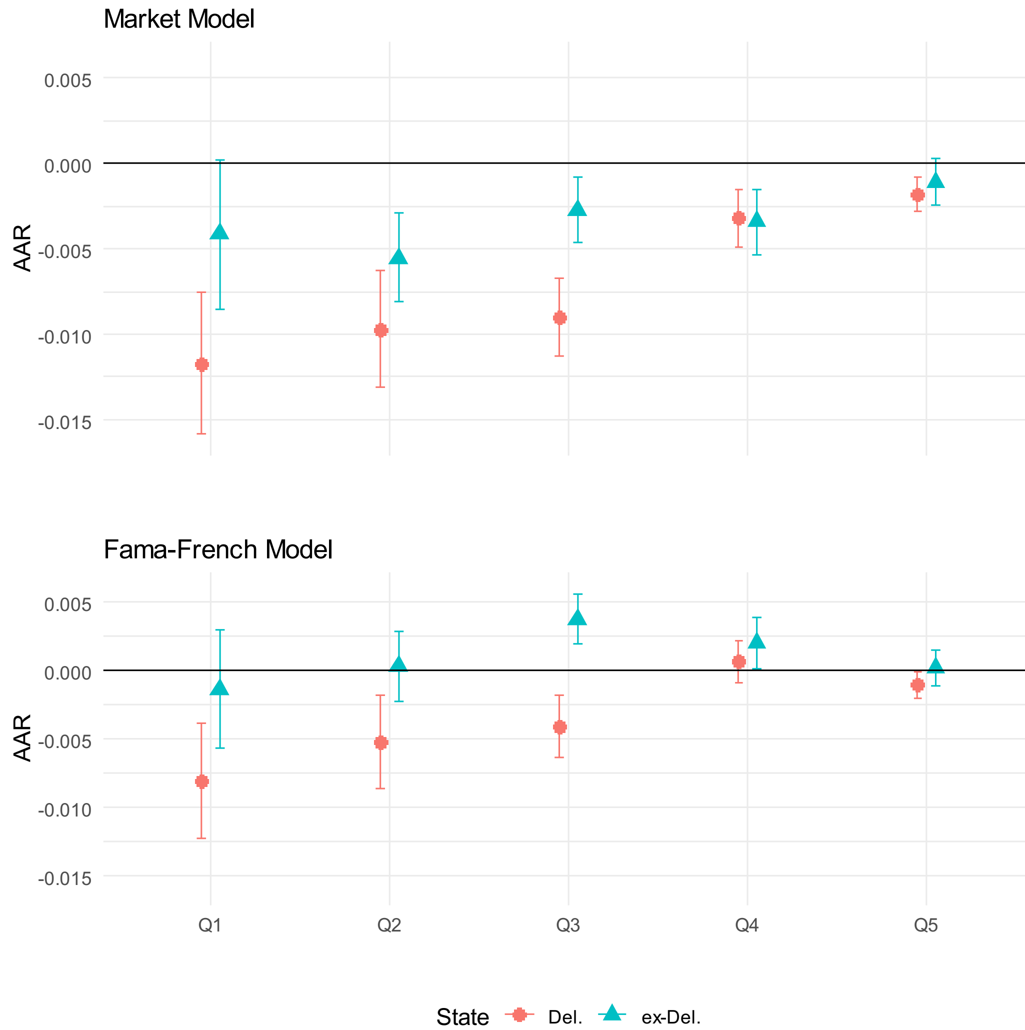


Figure presents estimates for the market reaction to district court's 12/6/2017 invalidation of Delaware courts' partisan-balance requirements. Circles denote AAR estimates for Delaware-incorporated firms. Triangles denote estimates for firms incorporated in other states. Q1 through Q5 categorize firms by market-capitalization quintile, with market cap measured at the beginning of the trading day on the event date. Bars signify 90 percent confidence intervals.

Figure A.2: Abnormal Returns for Delaware vs. Other Firms on Supreme Court Decision Date, by Firm Size Quintile

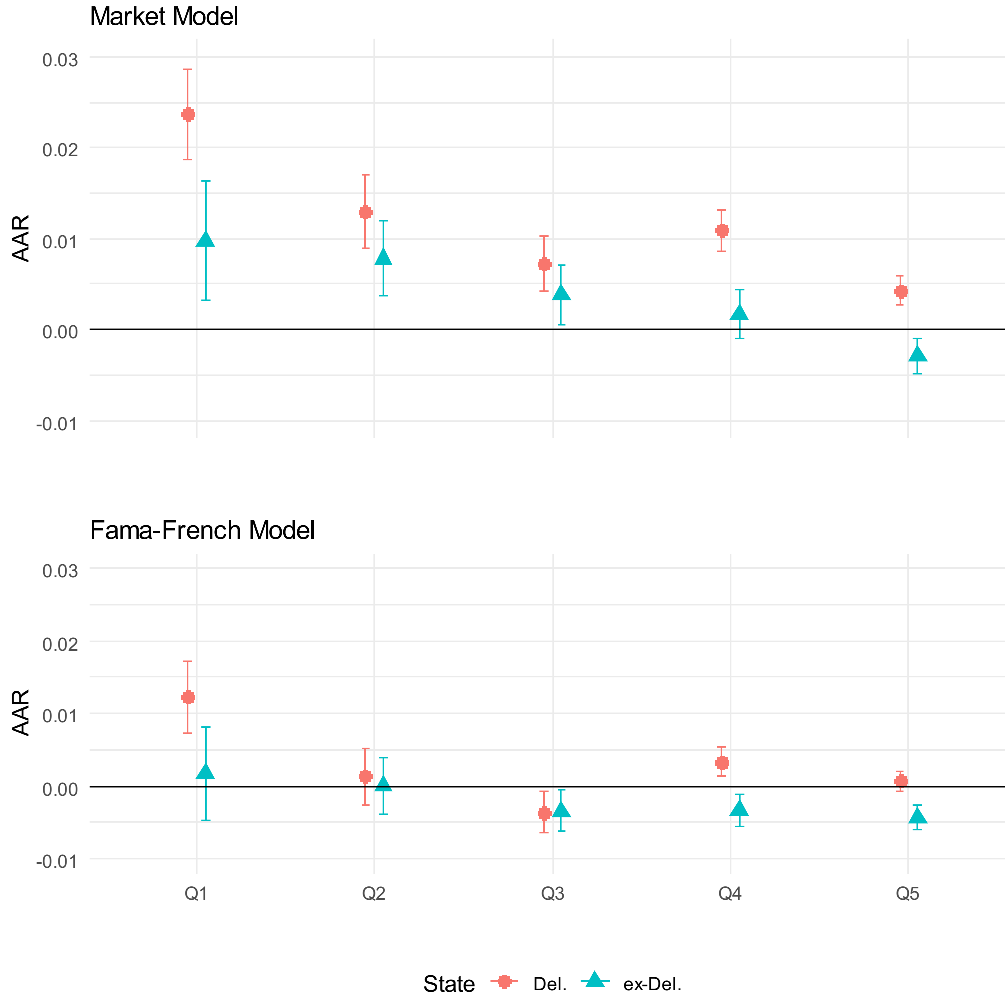


Figure presents estimates for the market reaction to Supreme Court's 12/10/2020 vacatur of the district court's judgment. Circles denote AAR estimates for Delaware-incorporated firms. Triangles denote estimates for firms incorporated in other states. Q1 through Q5 categorize firms by market-capitalization quintile, with market cap measured at the beginning of the trading day on the event date. Bars signify 90 percent confidence intervals.

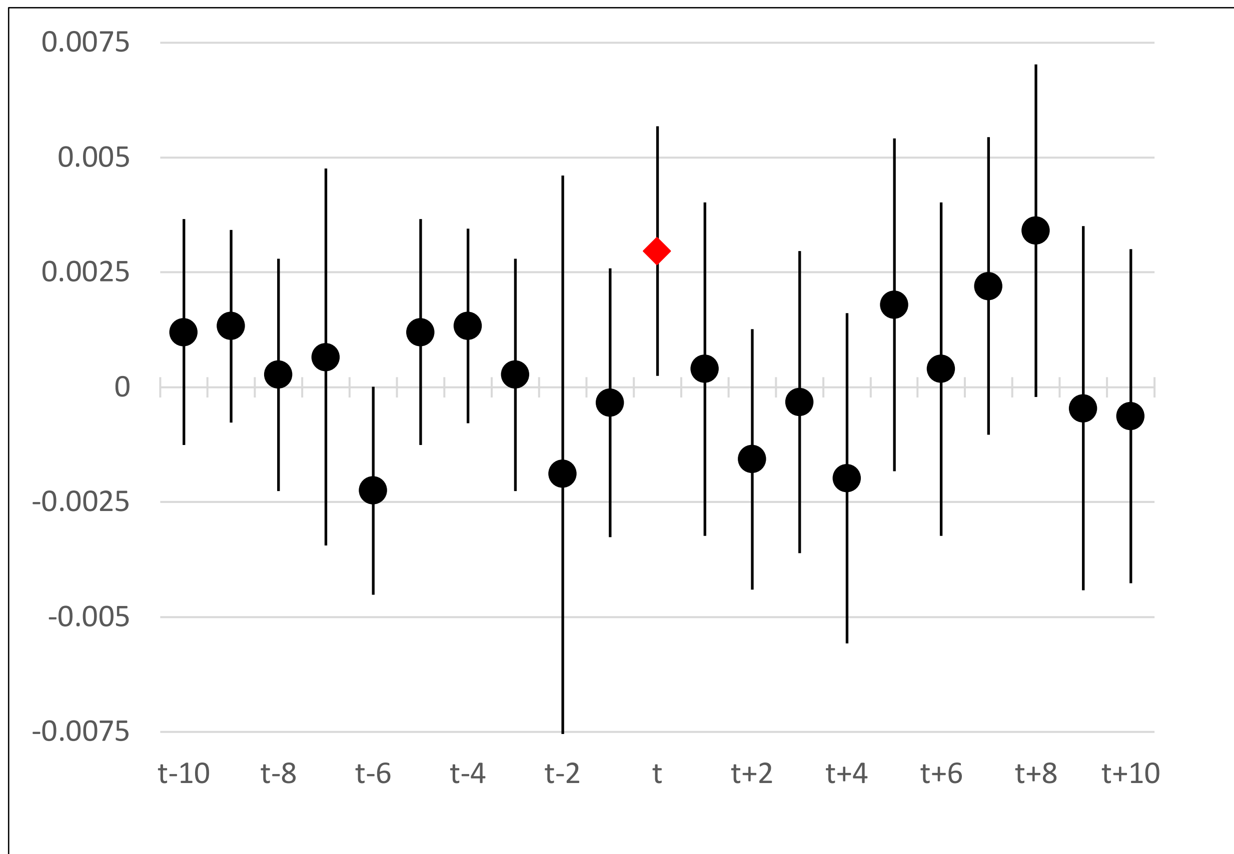
Appendix B: Additional Tests

This appendix assesses the strength of our principal findings concerning Hypothesis 2. We re-run Model 2 in Table 5 for each of the ten trading days on either side of the Supreme Court's issuance of its opinion on December 10, 2020. Because there do not appear to be any events that would differentially impact firms incorporated in Delaware versus other states in the leadup to December 10, we do not expect to observe statistically significant abnormal returns in this period. Likewise, we should not observe pre-trends, i.e., increasingly large abnormal returns in the leadup to December 10, because our research design assumes that markets did not fully account for the prospect of the Court's decision before that date. Further, because we expect markets to rapidly integrate high-profile news concerning securities traded on the premier U.S. exchanges, we do not expect to observe statistically significant abnormal returns in the day and weeks after December 10. Essentially, a same-day spike in abnormal returns on December 10 without similar abnormalities on either side of that date would provide additional support for Hypothesis 2.

Figure B.1 reports the results. Each point in the figure shows a coefficient estimate for the Delaware incorporation dummy variable in a regression of firms' day-to-day change in market returns on this variable and the other firm- and sector-level covariates included in Model 2 in Table 5. Black dots denote these estimates for the *Delaware* covariate for each of the ten trading days on either side of Supreme Court's decision on December 10, 2020. The red diamond shows the estimate for the *Delaware* covariate when this regression model is run for December 10.

Figure B.1:

Differential Performance of Delaware Corps. Around the Supreme Court's Decision



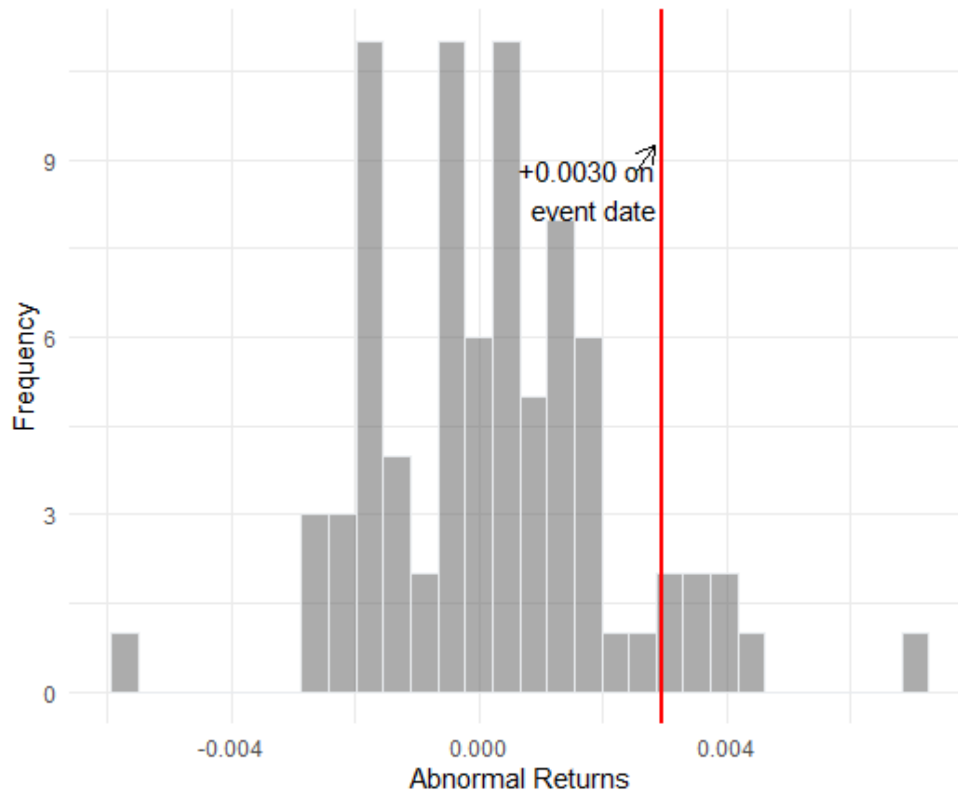
Diamonds signify estimates for *Delaware* covariate in Model 2, Table 5, which regresses firms' change in market returns on a given trading date [t - 10, t + 10] on Delaware incorporation, market value, book-to-market ratio, momentum, and sector fixed-effects. Event date t = 12/10/2020. Bars signify 90 percent confidence intervals.

Overall, the figure shows that the positive and statistically significant abnormal returns that Delaware corporations experienced on the decision date in *Carney v. Adams* were unusual. For all ten trading days on either side of this event, we cannot reject the null hypothesis that Delaware securities behaved no differently than other stocks at the $p < 0.05$ level. Neither does there appear to be any trend in the returns of Delaware corporations in the leadup to the Court's decision.

For another perspective, Figure B.2 shows the distribution of estimates for the *Delaware* covariate across 100 regression models, one for each of the 50 trading days on either side of the event date. The red vertical line marks the coefficient estimate for the event date. As the figure shows, the event-date estimate lies to the right of the mass of estimates, albeit not dramatically so:

7.1 percent of the estimates are larger in absolute value.[40] Essentially, Figure B.2 shows that the *Delaware* coefficient estimate on event date is a modest outlier, not an extreme one. That statement suggests that a degree of caution is appropriate in interpreting these results.

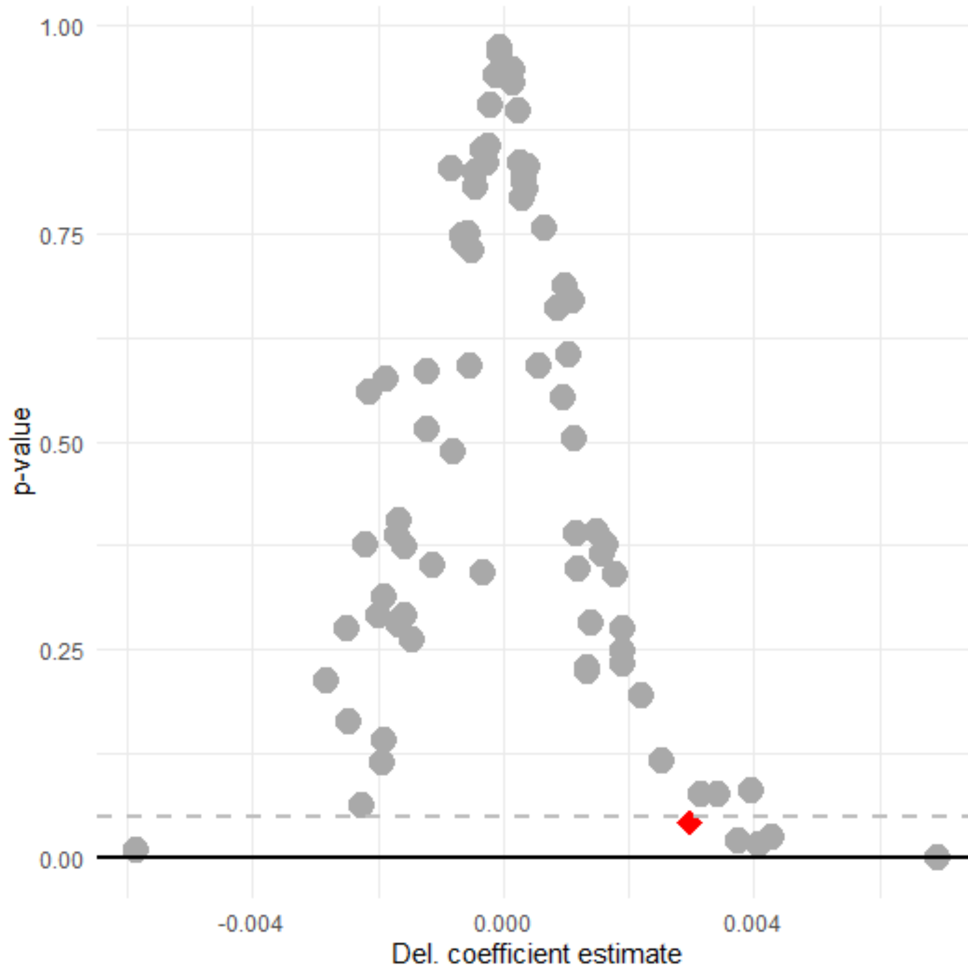
Figure B.2: Distribution of Coefficient Estimates for *Delaware* Covariate over 100 Trading Days



Finally, Figure B.3 plots, on the x-axis, each of these 100 estimates for the *Delaware* covariate and, on the y-axis, the associated *p*-value. For comparison, the red diamond marks the coefficient estimate and associated *p*-value for the event date. The conventional $p = 0.05$ level is marked with a dashed horizontal line for ease of reference.

[40] In absolute value, 8.1 percent of estimates are larger than the event-day estimate. In other words, this analysis yields a non-parametric *p*-value of 0.081 (see Wolfers & Zitzewitz 2016).

Figure B.3: Plot of Coefficient Estimates & *p*-values over 100 Trading Days



As Figure B.3 shows, only four estimates are both larger than the event-date estimate and statistically significant at $p < 0.05$.[41] As in the previous figure, Figure B.3 indicates that the event date is an outlier, but not an extreme one.

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[41] These dates are 1/19/21 ($\hat{\beta} = 0.0069$, SE = 0.0013, $p < 0.001$); 11/4/20 ($\hat{\beta} = 0.0043$, SE = 0.0018, $p = 0.024$); 10/14/2020 ($\hat{\beta} = 0.0041$, SE = 0.0016, $p < 0.016$); and 1/20/21 ($\hat{\beta} = 0.0037$, SE = 0.0015, $p < 0.020$). We cannot identify any events on those dates that would differentially affect Delaware corporations versus other firms. One would expect approximately five in 100 estimated relationships to be due to chance at the $p < 0.05$, and the figure reports exactly 100 such estimates.

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