unibz
Fakultät für Wirtschaftswissenschaften
Facoltà di Economia
School of Economics and Management

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# The Role of Mandatory Rules in the Law of Closed Corporations

Prof. Peter Agstner - Unibz

# Agenda

- ➢ Introduction
- ➢ Research trajectories
- ➢ Default rules vs. mandatory rules
- ➢ Comparative insights
- ➢ Areas of potential “strong” paternalistic intervention

# Introduction

- Fundamental topic across all scientific disciplines is the **dialectical relationship between freedom and authority**

- In the field of corporate law, an eminent scholar described this vexed problem as “the most difficult question in company law” (Wieland)

- In general, the idea of absolute private autonomy has been rightly compared to a “dream castle” (Wagner) or to a “mystifying beacon” (Röthel).

# Cont'd:

- Does this mean we should deny the **primary value of statutory autonomy** in the organization of corporate entities?
- **No**, because:
  - on the one hand, under conditions of perfect competition, contractual autonomy determines a **Pareto-efficient state of general economic equilibrium**; and

  - on the other hand, according to the Coase theorem, any intervention by a social planner would be futile, as parties will always agree on a distribution of resources that ensures **maximum overall welfare in the absence of transaction costs**, regardless of the original allocation.

# Cont'd:

- But it is **unrealistic** to assume perfect competition or a world without transaction costs populated by fully informed and rational *homines oeconomici* (or REMM)

- Especially scholars from behavioral law & economics field have provided strong empirical evidence of **behavioral market failures** in the form of bounded rationality and cognitive errors

- Therefore, especially in close corporations, it seems fundamental to adequately **govern (though not eradicate) contractual discretion**.

# Research trajectories

- Primary challenge lies in achieving — through the “visible hand of the law” — an effective balance between **respect for self-determination** and the **protection of relevant interest groups from prejudicial self-incapacitation**.

- This requires analyzing the dichotomous relationship between **default rules** and **mandatory rules** — the latter often described as “islands in a sea of default provisions” (Gambaro)

# Default rules *vs.* mandatory rules

- **DEFAULT RULES**

➢ **dual nature:** expression of private autonomy via opt-in/opt-out and of heteronomous regulatory power. Sunstein famously noted that "**default rules are canonical nudges**".

➢ they fulfil both **informative** and **integrative functions**, thereby reducing ex-ante transaction costs for shareholders

➢ reference point is generally the **majoritarian default rule**

# Cont'd

- Some argue that **default rules are ineffective against cognitive biases**

- In fact, given that cognitive limitations are persistent, shareholders might opt-out from the default framework even when it offers a presumably efficient protection

- Concerns are likely unfounded because of the **stickiness of default rules**, due to:
  - Transaction costs of contracting around
  - Endowment effect
  - Status quo bias

# Cont'd

- Stickiness ensures the preservation of the default rule by shareholders exhibiting rational apathy, **while** allowing more sophisticated parties to tailor different regulations to their needs.

- Ayres, 2012: "… to hinder opt-out by those contractors where the paternalism concern is high while allowing opt-out by those contractors where the paternalism concern is low".

# Cont'd

- **MANDATORY RULES**

- Rationale for mandatory rules lies in the need to protect people inside (**paternalism**) or outside (**externalities**) the corporate contract

- Two types of mandatory rules:
  - **Procedural rules:** make decision-making more rational, free, and informed
  - **Substantive rules:** more invasive and useful when market failures cannot be remedied procedurally, such as insurmountable information asymmetries or extreme power imbalances

- **Dual function**: provides a standardized structural framework and simultaneously performs inherent protective purposes

# Cont’d

- **Protective role cannot be underestimated a priori**.
  - In fact, in the absence of a minimum level of intangible protection, nothing prevents overly optimistic shareholders from waiving (opt-out) the soft paternalistic protection offered by majoritarian default nudges.
  - This problem is exacerbated in the context of close corporations, where shareholders are linked to each other by a “thick relationship” (Eisenberg)

# Comparative insights

**Comparative overview** focuses on:

- discourse surrounding the principle of *Satzungsstrenge* (statutory rigidity) in German company law;
- recent reforms enacted by the Delaware legislature through the Senate Bill 21 (2025) and Senate Bill 313 (2024)

# Germany

- German law is characterized by a dualism, namely *Gestaltungsfreiheit* vs. *Satzungsstrenge*

  - ***GmbH* law**: broad, though not unlimited, flexibility in internal corporate affairs (§ 45(1) *GmbHG*)

  - ***AG* law**: principle of statutory rigidity (§ 23(5) *AktG*) – unparalleled in the comparative landscape, except for Austria and Turkey. Principle forged by the jurisprudence of the *Reichsgericht* and formally introduced as black-letter provision (only) with the reform of 1965.

# Cont'd

- According to the principle of statutory rigidity, the articles of association may derogate from the provisions of the *AktG* **only if this is expressly permitted**.

- This rigid framework is justified by the **need for standardization to protect (current and future) investors and ensure legal certainty**. However, scholars increasingly agree that while rigidity suits listed companies, **greater flexibility is desirable for "closed" joint-stock companies** due to their typological similarity to the *GmbH*.

# Delaware

- Legislation on **LLC** gives maximum effect to the principle of freedom of contract (§ 18-1101(b) LLC Act)
- Same direction moves legislation on **corporations**, establishing very broad – but not unconditional – statutory autonomy (Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952))
- Now, witness **substantial change in Delaware corporate law**.
  - ➢On the one hand, reform package clearly inspired by **anti-contractarian objectives**: SB 21, amending §§ 144 and 220 DGCL
  - ➢On the other hand, decisive **contractarian turn** with SB 313 and new § 122(18) DGCL

# Cont’d: SB 21 and §§ 144, 220 DGCL

- **§ 144 DGCL** (labelled “billionaires-bill”)
  - ➢Delaware Supreme Court ruling in **In re Match Group** (2024) was a key catalyst, imposing entire fairness review on all controlling stockholder transactions unless **two cleansing conditions** were met (so-called **MFW doctrine**).
  - ➢§ 144 DGCL codified a more flexible standard—business judgment rule applies if **either** an independent committee **or** a majority-of-minority stockholder vote approves the deal, **except** for going-private transactions (freeze-out mergers)
  - ➢Now constitutional challenge is pending before Delaware Supreme Court.
- **§ 220 DGCL**: narrowed shareholder inspection rights

# Cont’d: SB 313 and sec. 122(18) DGCL

- **Moelis** (Del. Ch. 2024): pre-IPO shareholder agreement granted a founder-CEO sweeping pre-approval rights across a wide range of corporate actions, reducing the board of directors to an advisory body (now **reversed by Delaware Supreme Court**, Jan. 2026)
- Applying Section 141(a) DGCL and the Abercrombie test, the Court of Chancery **invalidated provisions that re-engineered internal governance by contract**.
- Three months after Moelis invalidated widely used stockholder agreements, Delaware enacted SB 313 and **sec. 122(18)**, authorizing corporations to enter stockholder agreements that would otherwise violate sec. 141(a)’s board-centric mandate.

# Areas of potential strong paternalistic intervention

- Reversal of the rule-exception relationship between default and mandatory provisions is **not recommended**

- Strong paternalistic intervention must be applied in a **timely and surgical manner**

- Attention focused on **paradigmatic agency conflicts** within closely held corporations, namely:
    - Agency conflict **between shareholders** in closed companies
    - Agency conflict **between directors and minority shareholders**
    - Agency conflict **between creditors and the company**

# Cont’d: Conflict between shareholders

- Shareholder conflicts constitute the Achilles’ heel of corporate governance in closely held companies

- Useful policy intervention would be a rule expressly imposing a **fiduciary duty of loyalty among shareholders**

- In Italy, U.S. and Germany the affirmation of such obligation is the result of case law, while Swiss legislature has codified this principle (Art. 803(2) *OR*).

- Mandatory duty of loyalty would signal a clear stance in favor of **proper relationship management, curb judicial “instability”, and prevent ex-ante waiver of fair treatment between shareholders**.

# Cont’d: Conflict between directors and minority shareholders

- **Business Judgment Rule** serves as the cornerstone of the director’s liability regime in public corporations, with directors benefitting from a **robust safe harbor**
- Is this fully justifiable in **close corporations**, which have different **structural characteristics**, namely strong risk aversion by shareholders, general illiquidity of the investment, and frequent overlap between majority shareholder and director?
- **Self-dealing transactions involving a conflict of interest between the director (-majority shareholder) and the company**: introduction of a mandatory liability rule based on the example of Art. 2391 C.C.

*Thanks for your attention!*