MANDATORY AND DEFAULT RULES IN PRIVATE LAW / Tomáš Gábriš

Abstract: The paper summarizes philosophical, historical and doctrinal background of the differentiation between mandatory and default rules in private law in general and in company law in particular. The conclusion of the author is the plea to provide for a clear guidance in the respective doctrine and legislation as to the criteria and principles applicable to distinguishing between the two types of regulations.

Key words: mandatory rules, default rules, permissive rules, legal realism, private law, company law, Slovak law


1. INTRODUCTION

The paper summarizes philosophy, history and theory (doctrine) of mandatory and default rules in private law in general and in company law in particular. Based on analysis of the two types of norms, along with the third type of so-called permissive norms, prescriptive guidance is hoped to be provided for both legal scholars and practitioners in their attempt at distinguishing between the respective types of norms. Of course, the best guidance would be an explicit regulation here. The problematic distinction between the two types of regulations together with challenging the traditional approaches favouring mandatory nature of company law may thereby be perceived as a realistic approach to the issue and to related legal problems.

2. PHILOSOPHY AND HISTORY

Legal rules or legal norms can be categorized based on numerous criteria. One of them is the traditional differentiation between mandatory rules and default rules. This distinction is taking into account the degree to which the rule-making authority is vested with the state or – in contrast – reserved to the parties. This distinguishing of norms is hence clearly interconnected with another categorization of legal norms into autonomous and heteronomous rules. The heteronomous ones are thereby the rules laid
down by officially enacted laws (Acts of Parliament, etc.), while the autonomous regulation is the one being set by the contracting parties themselves. An interesting middle category is thereby allegedly represented by collective labour agreements that are being made generally binding by the state, while being created by the autonomous contracting parties – hence showing both the characteristics of autonomous as well as heteronomous regulation. In addition to distinction between mandatory and default rules, however, a third category of rules can also be discerned – so-called permissive rules, which will be discussed infra, being situated at the crossroads between autonomous a heteronomous rule-making as well.

In private law in general, a relatively high degree of autonomy (freedom) is considered to be one of its philosophical backbones, at least since the times of victory of liberal political and legal thought. From a broader historical perspective, however, the recognition of "private autonomy" in modern law is all but a modern element. In fact, it can be rather perceived as a relic of a much broader historical concept of autonomous rule-making, which was very much characteristic of pre-modern and pre-liberal era, when the state and state-made law played only minor role in regulating various aspects of everyday life. It was namely only with the emergence of legislative monopoly of the state that autonomous rule-making has shrunk to what we know nowadays as private autonomy recognized by the state-made law. In other words, autonomy is generally not considered to be "law-making", but only making use of the possibility granted to the people by the state recognizing their contractual autonomy – which is in fact manifested inter alia by the existence of default legal regulation.

The current situation is thereby a heritage of the 19th century legal scholarship, in Central Europe being mostly influenced and inspired by German legal thought, witnessing back then a clash between Pandectists and Historical School of Law.¹ In this battle, the German Historical School of Law emphasized the importance of autonomous communities and their ability to create the "law". Thus, at the beginning of the 19th century, Karl Friedrich Eichhorn (1781–1854) distinguished between ius scriptum as denoting state-created laws, and ius non scriptum as being autonomous normative systems, or rules created by the judiciary in the form of a judge-made law (Meder, 2009, p. 44). These terms were similarly used by Joseph Anton Mittermaier (1787–1867) and Romeo Maurenbrecher (1803–1843); (Meder, 2009, p. 115). In addition, Georg Beseler (1809–1888), Otto Bähr (1817–1895) and Otto von Gierke (1841–1921) all jointly accepted the normative competence of societies and communities, due to their underlying element – the autonomy. Georg Friedrich Puchta (1798–1846) thus spoke of autonomy as a distinct source of power that corporations exert over their members, which is not of a contractual nature (Puchta, 1862, p. 28; quoted from Meder, 2009, p. 64).

These views were, however, overcome and abandoned in the German legal scholarship because the Pandectist approach was victorious in the end of the day, refusing autonomous law-making and limiting autonomy only to an element of law of obligations – to the extent recognized and allowed for by the state. It was specifically the figures and personalities such as Carl Friedrich von Gerber (1823–1891) and Paul Laband (1838–1918) who embraced the concept of legal thought which hoped to change the German Empire into a monolithic “Anstaltsstaat”, not recognizing any non-state-based normative autonomy. Thus, Gerber explicitly rejected autonomy as the source of law,

¹ A similar battle took place between Romanists and Germanists within the Historical School itself, especially with regard to the nature of legal persons – on the one hand, there was a theory of fictitious existence of legal persons, while on the other, Germanists such as Otto von Gierke were rather inclined to the idea of a real existence of legal persons.
claiming there is a difference between law-making and law enforcement – and autonomy thereby only means the power to act legally, but not to create law (Gerber, 1854, pp. 36, 46; see also Jhering, 1893, p. 320; both quoted from Meder, 2009, p. 60-61). Autonomy should thus not be considered a separate source of "non-state law", but rather only a source of contractual relations and legal acts, and therefore, a part of the law of contracts, Gerber claimed (Meder, 2009, p. 53). Otherwise, according to Laband, normative autonomy would necessarily conflict with the sovereignty of the state. Laband also quoted here Savigny, who claimed that legal acts are only sources of subjective rights, not of objective law (cf. Laband, 1911, p. 106; quoted from Meder, 2009, p. 63). Savigny even demanded that the term "autonomy" be abandoned altogether (Savigny, 1840, p. 12; cf. Meder, 2009, p. 64). In this spirit, Wilhelm Eduard Wilda (1800–1856) in 1842 transferred the notion of "Privatautonomie" from legislative and law-creating process into law of contracts too (Wilda, 1839, p. 547; quoted from Meder, 2009, p. 164). From then on, it was only a step from positivists such as Carl Bergbohm (1849–1927) and Hans Kelsen (1881–1973) to demand the recognition of the sole monopoly of state to create law. As an outcome, an exclusively state-based law-making was accepted. The concept of law without a state, and the notion of "autonomous" law were to be completely abandoned. Autonomy as a source of law thus shared the same fate as legal custom and legal science – they ceased to be considered a source of law altogether.

Based on the above-mentioned overview it is clear that this evolution represents a dramatic change and shift in the understanding of law, influencing our modern perception of law in continental Europe. However, the idea of state-independent rule-making never died away completely even in the 20th century. The Italian theorist of the 1930s, Santi Romano, a forerunner of the modern idea of legal pluralism, was one of those who proposed the idea that law is primarily a social phenomenon, and that each and every social institution forms its own social norms, thus creating its own "law" (Romano, 1975, pp. 44–45; cf. Di Robilant, 2006). Although this simple solution may not necessarily convince all opponents, the use of the term "law" to designate non-state-made standards was not at all uncommon in the 20th or 21st centuries: for example, in 1933, a German lawyer Hans Grossmann-Doerth used the phrase "selbstgeschaffenes Recht der Wirtschaft" (autonomous law of economy) as a synonym for general contract terms and conditions; similarly, the label of "autonomes Recht", "private Normenordnungen", "autonome Rechtsordnungen" or "Privatgesetzgebung" is still being used nowadays to denote non-state-based normative systems (Vec, 2004, pp. 96–97, 2008, pp. 155–166), such as lex mercatoria, lex informatica (lex digitalis, lex technica) (cf. Walter, 2004, pp. 48–49), lex sportiva (Ipsen, 2009, p. 32; Teubner, 1996, p. 255, 1997), or lex constructionis (the international construction standards); (see Kadelbach & Günther, 2011, pp. 19–21). Finally, the famous German lawyer Helmut Coing recognized similarly that in addition to state-formed law, there is also specific religious and international law, being actually examples of a "non-state" law (Coing, 1985, pp. 283–285; quoted from Meder, 2009, p. 78). One might, however, still be skeptical and believe that even these normative systems represent only a transitional stage, and in the future they will be subject to state control and to state-made norms as well (Ipsen, 2009, p. 246). In contrast, however, there is also a growing number of authors supporting the idea of non-state law and legal pluralism (de Sousa Santos, 1987), believing that states usurped throughout the 17th to 19th centuries powers which do not necessarily belong to a state, while claiming that states are now gradually withdrawing from the field, allowing once again for resurfacing of the autonomous "non-state" law (Zippelius, 2004, p. 161).

Be it as it may, at this point, state-made law surely still plays an important role in continental Europe, even in private law and company law – mostly with regard to

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safeguarding social functions of the law and of the state, such as guaranteeing minimum standards of human rights. The growing importance of autonomy is nevertheless also present, which leads to the need to re-assess the distinction between mandatory rules on one hand, and space for autonomy manifested in default norms on the other.

3. DOCTRINE EVOLVING: EXAMPLE OF THE SLOVAK REPUBLIC

Moving now from the philosophy to positivist doctrinal approaches in continental Europe with regard to mandatory and default rules, current situation is mostly that of lacking proper criteria for distinguishing between the mandatory and default rules. This problem thereby emerges both on a more general level of private law, as well as on the more specific level of company law – together with the discussions on the degree of autonomy for the parties to be recognized in these branches of law. To quote Petri Mäntysaari: "If one wants to increase the discretion of the parties and limit the scope of state regulation, one can regard the corporation as something similar to a contract and argue that freedom of contract should prevail. Alternatively, one can argue that the corporation is not a contract and that mandatory standardisation reduces transaction costs and benefits the society as a whole" (2012, p. 61).

The problem of relationship and distinguishing between mandatory and default legal rules is thereby not a new one and not without a properly evolved doctrine, as we shall explain shortly. However, due to the constraints of this paper, let us formulate a caveat for the reader here that we shall focus solely on doctrinal evolution in the territory of Slovakia, including historical predecessors of the Slovak Republic. Let us therefore start with the pre-1918 approach in what was then known as the Hungarian Kingdom (a part of Austria-Hungary), where the doctrine made a distinction between inner and outer relations of a business company (Horváth, 2006, p. 397). The inner relations were considered to be regulated predominantly by default rules, and it was made possible to have the relationship between partners (shareholders) regulated autonomously. In contrast, external relations were considered to be regulated by mostly mandatory rules with no possibility to deviate from them (unless explicitly allowed); (Horváth, 2006, p. 397).

A similar approach was taken over by the Czechoslovak Republic and its legal scholarship in the interwar period. In the – nowadays almost forgotten – 1937 draft of Commercial Code, separate chapters on internal relations among shareholders and external relations of the business company were included in case of public company and partnership company.\(^2\)

In case of a public company, Sec. 114 of the draft stated that within internal relations, default rules apply predominantly, with some explicitly stated exceptions. In contrast, under Sec. 152, external relations were regulated in principle by mandatory rules, again with some explicitly stated exceptions.

In case of a partnership company, under Sec. 199, in principle default rules were introduced with regard to regulation of internal relations, with the exception of explicitly specified Sections of the draft. Interestingly, even with respect to the specific type of silent company, which was only briefly regulated in the draft of 1937, the internal relations were also to be regulated by default rules (Sec. 225).

This general concept making distinction between explicitly specified internal and external relations was thereby explicitly explained and confirmed in numerous places of

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\(^2\) The unfinished draft only dealt with these two basic forms of companies, and additionally contained some rules on the so-called silent company.
the explanatory memorandum to the draft of 1937 (Osnova obchodního zákona, 1937, pp. 161, 172, 182, 208), accepting and streamlining the doctrinal approach under which default rules were considered as a standard and mandatory rules as a specific deviation with respect to regulating (enumerated) internal relations of a company, while the opposite was true for external relations between company and its business partners or general public.

Unfortunately, this draft project was never enacted by the parliament of Czechoslovakia, and instead the formerly Austrian and Hungarian law (commercial codes) applied in the territory of Czechoslovakia up until 1950. Only in 1950, under completely different circumstances of one-party (Communist Party) rule, new Civil Code was enacted, which abolished the two (originally Austrian and Hungarian) Commercial Codes valid in two parts of Czechoslovakia, and instead partial commercialization of the Civil Code was introduced. Under the Communist Party regime, no company law was namely considered necessary – private entrepreneurship was completely abolished and only state-owned companies were allowed, which were regulated by specific governmental regulations and acts of the parliament. The doctrine on mandatory and default rules in company law thus sunk into oblivion.

Commercial Law remained in existence only with respect to international commerce, being regulated in the Code of International Commerce (Act No. 101/1963 Coll.). This Code, however, regulated only law of commercial obligations and no company law proper. Under its Sec. 5, it was simply stated that: “The Parties may agree to provide for a derogation from the provisions of this Act, unless expressly provided that they may not be derogated from.” Hence, a general rule on default nature of rules was introduced in this Code, but without any underlying doctrine or theory, simply as a concession made to the foreign business partners.

In contrast, a different doctrinal principle was laid down in the new Civil Code of 1964 (still applicable in Slovakia even nowadays, albeit being heavily amended), where no specific rule on relationship between default and mandatory rules was originally expressed in the wording of the Civil Code at all. In practice, severe ideological constraints on the possibility to deviate from the rules of the Code applied, making thus the Code a rather mandatory system of rules where even the distinction between private law and public law was explicitly rejected.

It was only after 1989 that changes were introduced in this regard, emphasizing again the autonomy and freedom of natural and legal persons in a democratic and liberal regime, especially in the private law branches. A new Sec. 2 (3) was introduced in the Civil Code, which has provided for some guidance with respect to the relationship between mandatory and default rules. It namely allowed to derogate from the provisions of the Civil Code by mutual agreement, unless “the law expressly prohibits it or unless the nature of the provisions of the law implies that they cannot be derogated from.” However, as may be seen from this wording, the Civil Code unfortunately provides in no way a clear guiding principle to distinguish between the two types of norms – mandatory and default rules.

In contrast to the Civil Code, Sec. 263 of the Commercial Code (enacted in Czechoslovakia in 1991) explicitly enumerates the mandatory provisions from which the contracting parties may not deviate in adjusting their rights and obligations. However, this only applies to the law of obligations in the Commercial Code. The Code does not provide for any special criteria for determining the mandatory or default standards in other parts of the Commercial Code (notably in the part on company law), where therefore only the unclear rule contained in Sec. 2 (3) of the Civil Code applies instead, leaving much to be wished for.
Precisely due to this type of uncertainty, there are radically differing approaches taken by Slovakian scholars nowadays as to the prevailing nature of legal norms in the Commercial Code (and broadly speaking in commercial law, including company law) in Slovakia. Šuleková (2015, p. 19) summarizes that according to Koláriková, "it can generally be stated that the provisions of the Commercial Code governing companies are predominantly mandatory, given their nature. However, a default nature of a provision is unquestionable if it contains, for example, the wording such as "unless the articles of association or statutes state otherwise"." (2013, p. 123) Unlike Patakyová, who also considers the nature of rules in the Slovak company law to be predominantly mandatory (2013, p. 4), Mamojka Jr. differentiates between the inner and outer relations of business companies, stating that "while a particular external world of each company is more or less mandatorily given by law (company’s establishment, formation, abolition) their internal life is made up of a number of legal ties mainly operating on the above-mentioned principle of default rules." (2008, p. 15). Unfortunately, this doctrinal explanation lacks an explicit provision in the Slovak legal system, making thus this view to be only one of many possible doctrinal views on the nature of the Slovak company law.

Instead of clear doctrinal and legislative guidance, the final word in discerning mandatory and default rules is therefore currently being given into the hands of judiciary. However, relying only the piecemeal judicial interpretation is not really the most convenient solution in the branch of commercial or company law – due to the obvious lack of legal certainty. Thereby, it is precisely the legal certainty, hand in hand with the need of a fast dispute resolution process (notably via arbitration) and some elements of speculation, that together lie at heart of modern commercial (company) law in its capitalist form and shape (cf. Coing, 1989, p. 535).

A clear and definite solution of the issue should thus be sought for, to provide clear guidance to the business companies and their business partners not only in the Slovak Republic.

4. POLICY AND RECOMMENDATIONS: REALISTIC STANCE

In addition to the "realistic" view of solely judicial (and often non-systematic) determination of company law rules as mandatory or default, some other traditional doctrines are also being challenged by sceptical and realistic views of company law and its standards. Thus, on top of the distinction between mandatory ("shall") and default ("unless") standards, the doctrine currently discusses also the existence and importance of a third type of norms, very often found in current wordings of legal texts of company law – the so-called permissive ("may") rules. Unlike the default rules, which apply provided that the addressees of the standards do not depart from these (opt-out mechanism), the permissive rules contain no default rule, only refer to the possibility of introducing specific rules of autonomous law. Permissive standards thus require the addressee of the standard to exert his or her will (opt-in mechanism) to reach the effects envisaged by this standard (Šuleková, 2015, pp. 71–72), which hence serves as a sort of a “nudge” for the recipient of company law norms.

Thereby, permissive rules are often being introduced in legislative practice in a rather haphazard way, throughout the ongoing process of amendments to the binding texts, usually in reaction to a one-time (casuistic) problem in legal practice – mostly where even the experts were not quite sure whether the practice was allowed on the principle of default regulation or not, and therefore they rather opted for an explicit permission instead.
Still, this third type of norms only adds to the complexity of the overall situation and is in fact not helpful in any way in identifying which rules are mandatory and which apply by default. In contrast, they are further blurring the duality of mandatory and default rules.

The problem but potentially also the solution to the problem thus seems to be hidden in the very legislative technique and instruments used in legislating on company law. A better theory of legisprudence thus seem necessary to master the criteria of distinction between the mandatory and default rules by both practicing lawyers as well as by business entities themselves, which should then also lead to a more predictable judicial decision-making.

Thereby, the already mentioned “nudging” and other similar concepts of Law&Economics or Law&Behavioral Economics movements are recently being invoked in this context.

The Law&Economics stream of legal thought namely suggests that the state can sensibly specify default rules when a large number of parties face the same problem and the state-supplied solution costs less than the total benefit to the affected class of parties – i.e., if the benefit of the parties prevails over costs imposed by default rules (Scott, 2000, p. 160). In other words, Law&Economics approach suggests that the role of the legislation is to bring about a result that the parties would be likely to achieve if the transaction costs were zero or at least minimal. Default rules are thus claimed to be reducing transaction costs that would otherwise have to be incurred.

However, this view can be agreed with only partially, since the default legal rules often do not introduce the best option for the parties, and do not represent what sufficiently informed parties would potentially agree upon. According to Šuleková, the default rules are instead often formulated so as to balance the conflicting interests of the parties to the legal relationship. She speaks of the so-called "penalty default rules", i.e. default rules causing effects that the parties would normally not want to achieve, making thus the parties motivated to deviate from the default rules (2015, p. 68).

In any of the two interpretations it still holds true that besides economic aspects, the psychology of the addressees of law plays an important role too. This is the point where instead of the classical Law&Economics movement, rather the Law&Behavioral Economics line of legal thought steps in.

The role of psychology with respect to the problem of mandatory and default rules is thereby in no way a new idea. Already the prominent 20th century communist legal scholar from Czechoslovakia, Viktor Knapp, stated frankly that default and mandatory norms are usually not recognizable from the wording of the law itself; instead, lawyers recognize the nature of the norm through intuition, Knapp suggested (1995, p. 2).

This claim, being close to the ideas of sceptical legal realism, is thereby nowadays being scholarly backed also by recent research outcomes in the field of behavioural economics. Behavioural economics namely works with the concept of cognitive biases, which can be witnessed also in company law, even with respect to distinguishing mandatory and default rules: Any wording of the law, be it mandatory or default, namely poses a challenge to the independence of human judgment and decision-making. The person is rather inclined to stick to the wording at hand, instead of phrasing other solution. This is a so-called "status quo" or a related "anchoring" cognitive bias,
which causes us to remain at the regulation introduced by the law, and to consider this as a guiding, mandatory rule. Therefore, it is claimed that even the judges with many years of practice often (mis)interpret the autonomous rules created by contracting parties (shareholders) rather in the light of the notions used in the law, instead of going into deeper analysis of what and how the parties themselves intended to regulate. In words of Robert E. Scott, "while the state presumably knows what it means by the default rules that it implies in every contract, it does not know the intended meaning of the express terms chosen by the parties. Thus, privately formulated express terms are always subject to an additional risk of unpredictable (or nonuniform) interpretation. Contracting parties face an inherent risk that an express term that was designed to trump the default terms of the contract will be interpreted instead as merely supplementing the default understanding" (2000, p. 164).

Still, knowing and realizing this inclination (bias) is the first step in the right direction to be taken by both the judges as well as by business companies. In fact, this again has to do with the behavioural economics, distinguishing between three possible approaches to take in a society – (1.) descriptive ("positive"), (2.) normative, and recently added so-called (3.) "prescriptive" approach as a third stance found in the middle between the former two. Taking economy as a subject matter to explain these three approaches to society, descriptive economy only describes the behaviour of individual actors, especially in psychological, behavioural (nowadays rather "cognitive"), or institutional ("institutionalist") terms. Normative economy, on the other hand, prescribes ideal economic standards for an ideal world – this approach, however, is often accused of being detached from "reality". Therefore, a third way of so-called prescriptive economy is being developed, which "prescribes" behaviour to real actors in the real world (cf. Pearlman, 2009). Normatively correct answers may namely not always be also "prescriptively" correct in specific situations. Searching in similar terms for a prescriptive guidance in legal practice – specifically with respect to mandatory and default rules in company law, a working "prescriptive" legal guidance is to be offered for both enacting effective laws on one hand and for actual implementation and application of such laws on the other.

At this point, an efficient prescriptive guidance in former case (at the level of lawmaking) thereby seems to be to introduce a combination of explicitly given mandatory rules and explicitly identified default rules (or explicit criteria for their discernibility) in the legal texts of company law – as for example in the Czechoslovak draft of commercial code of 1937. Still, until this materializes in the legislative form, practical "prescriptive" recommendation would be to take into account the overall inclination to interpret legal rules as rather mandatory, and to attempt to argue against this attitude with the help of the doctrinal arguments employed in this paper – until a legally binding guidance with clear criteria will be provided for by the legislator. Of course, a realistic prescriptive approach would also require taking into account the actual case law developed in this area while shaping the argumentation – instead of arguing stubbornly against the already accepted judicial practice...

5. CONCLUSION

A counterpart to the mandatory rules of law is traditionally being seen in the so-called default rules. However, the current situation in drafting legislative texts is that of exploiting not only these two types of rules, but also a specific sub-type of so-called permissive rules. These are rules which are not default rules in the proper sense of leaning on default regulation in case the parties do not agree otherwise. Just the opposite is true
permissive rules are not applicable by default. They rather “nudge” the parties (or a judge) to accept a regulation they might not have thought of as permissible. Thus, in fact, this type of norms serves to clarify the extent to which the autonomous rule-making by the parties or shareholders is to be accepted. This necessity on its own proves on the one hand the fact of general inclination towards considering all legal norms as mandatory (due to the status quo and anchoring biases forcing everyone to stick to the rules known and explicitly given), while on the other hand, the use of permissive rules is also a very prescriptive (albeit at the same time very casuistic) tool to guide the parties to the area of autonomy in company law. An explicit wording and explicit rules hence still seem to play the greatest role in identifying the borders between mandatory and default rules, and between heteronomy and autonomy in company law. All of this is finally pointing to the general need for clear and explicit guiding principles expressed in legislation (or at least in a generally accepted doctrine) on how to discern which norms (or sectors of regulation) are mandatory and heteronomous, and which can be deviated from, based on the principles of freedom and autonomous governance...

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