



# General Assembly

Distr.: Limited  
16 January 2019

Original: English

**United Nations Commission  
on International Trade Law  
Working Group I (MSMEs)  
Thirty-second session**  
New York, 25–29 March 2019

## **Draft Legislative Guide on an UNCITRAL Limited Liability Organisation**

### **Note by the Secretariat**

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## Background information

1. At its forty-sixth session in 2013, the United Nations Commission on International Trade Law (UNCITRAL) decided to work towards reducing the legal obstacles and barriers encountered by micro, small and medium-sized enterprises (MSMEs) throughout their life cycle, with a particular focus on their context in developing economies.<sup>1</sup> The Commission understood the life cycle of a business consist of several stages, which would include starting, operating, restructuring and dissolving a business. The mandate granted to Working Group I by the Commission was that work should focus on the first stage in that life cycle, i.e. starting a business.<sup>2</sup>

2. Working Group I began its deliberations on that subject at its twenty-second session in February 2014 and from its twenty-third session, in November 2014 to its thirtieth session, in March 2018, it proceeded to consider two main topics, one of which related to a simplified business entity suited to the needs of MSMEs.<sup>3</sup> Those deliberations were based on the framework of issues drawn from the key features of simplified business regimes (outlined in [A/CN.9/WG.I/WP.86](#)), and as illustrated in the draft model law on a simplified business entity ([A/CN.9/WG.I/WP.89](#)), as well as other possible models (for example, that contained in the annex to [A/CN.9/WG.I/WP.83](#)).

3. Following its discussion of the framework of issues that might be considered in a simplified business entity regime, at its twenty-sixth session (New York, 4 to 8 April 2016), the Working Group decided that the legislative text it was preparing on a simplified business entity should be in the form of a legislative guide. To that end, the Working Group requested the Secretariat to prepare for discussion at a future session a draft legislative guide (consisting of recommendations and commentary) that reflected its policy discussions to date.<sup>4</sup> This draft legislative guide has been prepared by the Secretariat in response to that request.

4. The Working Group started considering the draft guide at its twenty-seventh session (Vienna, 3 to 7 October 2017) and continued such work at its twenty-eighth session (New York, 1 to 9 May 2017). At those sessions, it considered all sections of the guide save for sections G to L. The Working Group devoted its twenty-ninth (Vienna, 16 to 20 October 2017) and thirtieth (New York, 12 to 16 March 2018) sessions to reviewing the draft legislative guide on key principles of a business registry<sup>5</sup> and resumed its discussion on the draft legislative guide on an UNLLO at its thirty-first session (Vienna, 8 to 12 October 2018). At that session, the Working Group considered a revised draft of the legislative guide (as it appeared in working paper [A/CN.9/WG.I/WP.112](#)) including changes arising from deliberations at its twenty-seventh and twenty-eighth sessions. The following recommendations (and attendant commentary) were discussed: recommendations 7 to 12 (Sections B and C), save for recommendation 10; recommendation 15 (Section D) and recommendations 16 and 17 (Section E).

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<sup>1</sup> *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* ([A/68/17](#)), para. 321; reiterated at subsequent sessions of the Commission: *ibid., Sixty-ninth Session, Supplement No. 17* ([A/69/17](#)), para. 321 and *Seventieth Session, Supplement No. 17* ([A/70/17](#)), paras. 220, 225, 340 and 321.

<sup>2</sup> The Commission stated that “such work should start with a focus on the legal questions surrounding the simplification of incorporation” and confirmed in subsequent sessions Working Group I’s approach that such work should proceed on two relevant issues: legal questions surrounding the creation of a simplified business entity and key principles in business registration. *Supra*, note 1, and *ibid., Seventy-first Session, Supplement No. 17* ([A/71/17](#)), para. 224.

<sup>3</sup> Report of Working Group I (MSMEs) on the work of its twenty-sixth session, [A/CN.9/866](#), paras. 22 to 47.

<sup>4</sup> *Ibid.*, paras. 48 to 50.

<sup>5</sup> The draft legislative guide was finalized and adopted by the Commission at its fifty-first session in 2018. See *Official Records of the General Assembly, Seventy-third session, Supplement No. 17* ([A/73/17](#)), para. 111.

5. The current revision of the draft legislative guide includes the changes arising from the deliberations of the Working Group at its thirty-first session. The Secretariat has also made additional adjustments necessary to facilitate the cohesion and consistency of the text. In some cases, such adjustments have resulted in changing the order of the recommendations and the relevant commentary: those recommendations have been renumbered consecutively and any cross-reference adjusted accordingly. Guidance to the changes made is reflected in footnotes throughout the text.<sup>6</sup> In addition, “Notes to the Working Group” have been added in certain sections of the text to draw attention on key issues underlying the draft guide that require further consideration by the Working Group.

6. The text of the draft legislative guide is reproduced as an Annex by this Note of the Secretariat for consideration by the Working Group.

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<sup>6</sup> The Working Group may wish to note that the current text of the draft guide includes some footnotes relating to changes arising from deliberations of the Working Group prior to its thirty-first session. These footnotes have been retained for portions of the draft guide that have not been considered yet by the Working Group.

## Annex

# Draft legislative guide on an UNCITRAL Limited Liability Organisation (UNLLO)

## I. Introduction

### A. Purpose of the legislative guide<sup>1</sup>

1. Most businesses in the world are MSMEs. As data illustrate, they constitute the vast majority of business types in all States and represent the backbone of economy in many of them. Across regions of the world, MSMEs account for a large part of the employment rate and of the Gross Domestic Product (GDP). Despite this major role, several factors still interfere with their performance and capacity to develop. Globalization and economic integration offer growing opportunities for tapping into new markets and expanding business, in particular for businesses that can take advantage of economies of scale. International fora and organizations, as well as individual States, recognize the importance of strengthening the economic role and position of MSMEs to enable them to benefit from an evolving international economic environment. UNCITRAL has underscored that importance through its decision to take up work on reducing the legal obstacles faced by MSMEs in their life cycle. This work has resulted in, *inter alia*, the preparation of this legislative guide on an UNCITRAL Limited Liability Organisation.

2. Various States representing different legal traditions around the world<sup>2</sup> have adopted legislation on simplified business forms to facilitate MSME formation and operation. Those business forms can be of the corporate, partnership or hybrid type,<sup>3</sup> and they can provide for single member businesses<sup>4</sup> or for business forms that may not necessitate the granting of legal personality, while permitting asset partitioning.<sup>5</sup> Regardless of their more specific features, those laws all aim for simplified formation, flexibility of organization and operation, and asset partitioning.

3. Many of these business forms have enjoyed success in their respective jurisdictions. Their adoption permitted lower entry barriers, provided effective organizational solutions and reduced transaction costs, thus increasing employment opportunities and economic growth rates. Moreover, the adoption of these new business forms has promoted access of the businesses to the formal economy. The various domestic approaches to creating or reforming such business forms – both MSME-specific and otherwise – have highlighted that good practices around the

<sup>1</sup> The Working Group may wish to note that the Secretariat has thoroughly revised section A “Purpose of the draft legislative guide” (paras. 5 to 26 of [A/CN.9/WG.I/WP.112](#)) to eliminate redundancy and to improve clarity of the text.

<sup>2</sup> A selection of such business forms included in the comparative analysis that the Working Group first considered in this regard ([A/CN.9/WG.I/WP.82](#)) was drawn from 11 different States from different regions of the world and included 16 different legal regimes in total.

<sup>3</sup> See for instance, Colombia, France, Germany, India, Japan, New Zealand, Singapore, South Africa, the United Arab Emirates, the United Kingdom of Great Britain and Northern Ireland, and the United States of America.

<sup>4</sup> Information shared with the Working Group has included, for example, that in respect of the “auto-entrepreneur”, in force both in France (see paras. 22 to 23 of [A/CN.9/WG.I/WP.87](#)) and the Member States of the Organisation for the Harmonization of Business Law in Africa (known by its French acronym, OHADA) (*Acte Uniforme Révisé Portant Sur Le Droit Commercial Général*, adopted 15 December 2010, see [www.ohada.com/actes-uniformes/940/999/titre-2-statut-de-l-entrepreneur.html](http://www.ohada.com/actes-uniformes/940/999/titre-2-statut-de-l-entrepreneur.html)). Other efforts to create particular regimes for single member businesses have included that of the European Union (Proposal for a Directive of the European Parliament and of the Council on single-member private limited liability companies, European Commission, Brussels, 9.4.2014 (COM (2014) 212 final)).

<sup>5</sup> See the alternative legislative models for micro and small businesses described by Italy and France in [A/CN.9/WG.I/WP.87](#) and [A/CN.9/WG.I/WP.94](#).

world share a number of key principles which could thus be said to be international in their application.

4. The legislative guide attempts to distil these good practices and key principles into a series of recommendations on how a State could devise and regulate a simplified legal form for MSMEs that can best facilitate their success and sustainability, thereby stimulating entrepreneurship and innovation. The commentary that precedes each recommendation relies both on specific legislative efforts to provide for single member businesses or business entities, as well as broader reforms to assist MSMEs that have been implemented in various States,<sup>6</sup> so as to explain in greater detail the rationale leading to those recommendations.

## 1. “Think small first”

### (a) Assessing the needs of entrepreneurs

5. As emphasized in several of the legal reforms mentioned in the paragraphs above, a legislative regime for a ready-made business form should start with a focus on the actual needs of the smallest business entities and avoid placing unnecessary legal burdens on them. In keeping with this approach, as well as with the desire to create a legal text that can accommodate the evolution of an MSME from a very small entity to a more complex multi-member entity,<sup>7</sup> a “think small first” approach has also been taken in the Guide.<sup>8</sup> To that end, consideration has been given to how MSME entrepreneurs could most benefit from legislation based on these recommendations and be encouraged to conform to the rules they contain. Such entrepreneurs could range from individual street vendors, to small family business owners wishing to scale up and formalize their operations, to small firms seeking to grow and position themselves in more innovative sectors, such as the information technology field, and to women entrepreneurs facing unfavourable institutional and legislative frameworks.

6. In order to “think small first” and assess how best to design these legislative recommendations, the Guide focuses on the needs of MSME entrepreneurs. These could include a number of items, but it is suggested that, at a minimum, such needs might be the following.

#### (i) Freedom, autonomy and flexibility

7. MSME entrepreneurs could be expected to want *freedom and autonomy* to decide for themselves how they operate their business without the need to resort to rigid and formalistic rules and procedures or have detailed mandatory requirements regarding the conduct of their activities. They also would want the *flexibility* to adapt to changing circumstances that may impact MSMEs more than larger companies, and consider how their business might evolve and develop over time.<sup>9</sup>

#### (ii) Simplicity and accessibility

8. MSME entrepreneurs are likely to want *speed and simplicity* to characterize the rules on the legal establishment of their business, and on its administration and operation. These rules should be in simple and *accessible* terms, and the use of modern technology, such as mobile applications to complete payments or prepare balance sheets, should be encouraged.

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<sup>6</sup> Information in respect of such reform efforts in a number of States, including Chile, China, Colombia, El Salvador, Mexico, the Philippines, Rwanda, Thailand, and others has been shared in the Working Group.

<sup>7</sup> As agreed by the Working Group at its previous sessions (see paras. 24, 32 and 42 to 43, A/CN.9/800, paras. 67 and 74, A/CN.9/825, and para. 19, A/CN.9/831).

<sup>8</sup> See paras. 1 and 5 of A/CN.9/WG.I/WP.86/Add.1; para. 3 (iii) of A/CN.9/WG.I/WP.90; and paras. 2 and 39 of A/CN.9/WG.I/WP.89.

<sup>9</sup> The Secretariat has made editorial adjustments to this paragraph (para. 12 of A/CN.9/WG.I/WP.99) for further clarity.

(iii) *Identity and visibility*

9. MSMEs need an *identity and visibility* in order to more successfully compete in the market, domestic and globalised, and to attract more and better quality clients. In addition to the obvious protections and advantages associated with taking on a legally recognized identity and operating within a recognized legal framework,<sup>10</sup> the business can also use such legally recognized identity to develop its reputation and “brand” and increase its value.<sup>11</sup>

(iv) *Certainty and protection of property rights*

10. Regardless of the size of their business, all entrepreneurs need *certainty in and protection of their property rights*. As such, MSME entrepreneurs may be expected to want to control the ownership rights in their business and be able to take advantage of asset partitioning to protect their personal assets from claims that creditors may have against the business. It is also important that personal creditors of business owners and managers cannot seize business assets in order to satisfy personal debts.

(v) *Control and management*

11. Finally, MSME entrepreneurs generally want *to control* and *to manage their business*, rather than leaving administrative and strategic decisions to an external manager.

**(b) Drafting the guide from a “think small first” perspective**

12. Not only have the needs and expectations of MSMEs been assessed from a “think small first” paradigm, but the legislative guide itself is also drafted from that perspective. For example, MSME entrepreneurs’ need for freedom, autonomy and flexibility is woven through the guide in its recognition of the importance of freedom of contract and avoidance of formalistic and rigid corporate law rules. However, it is acknowledged through many default rules that such entrepreneurs may also require protection against circumstances or events that may not be foreseeable.

13. Simplicity and accessibility characterize not only the recommendations for rules on the establishment of the business entity (see also para. 8 above), but this guide as a whole also uses accessible terminology, and clearly acknowledges and welcomes the use of technological innovation. In addition, to provide MSMEs with identity and visibility, the recommendations provide the business entity with legal personality and set out a simple vehicle for the entrepreneur to create a legally recognized business. Further, limited liability protection for the business entity and rules on the transfer of rights of its members are some of the mechanisms that provide certainty and protection for the property rights of MSME entrepreneurs. Finally, control by MSME entrepreneurs over the operation and management of their business is assured through an emphasis on management by the members of the business entity as the default governance approach and on the more horizontal governance structure that characterizes the Guide.

**2. Creating a stand-alone regime**

14. Different approaches can be taken to achieving the goal of creating a specific and simplified legal form to facilitate the operation of MSMEs. They may range from updating existing company law, to introducing new legal forms explicitly linked to the traditional company law framework, to adopting a completely new legal statute.

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<sup>10</sup> Such protections and advantages have been enumerated in para. 31 of A/CN.9/941, and include, inter alia, asset partitioning, protection against potential administrative abuse and other abuse of rights, easier access to credit, labour law protection for employees, and similar features.

<sup>11</sup> On the importance of business registration to provide a commercial identity to a business, see the UNCITRAL Legislative Guide on Key Principles of a Business Registry (“the Guide on Business Registration”).

15. In view of that objective and recognizing that more formalistic and rigid corporate-style rules may not be appropriate for simplified business forms, the legislative guide has taken the view that the optimal solution for the creation of an appropriate simplified legal regime for MSMEs should not be to reform and simplify existing company law regimes, but rather to develop a separate and innovative alternative based on the collective domestic experiences of States and specifically tailored to the needs of MSMEs.<sup>12</sup> Therefore, the guide has drawn ideas from good practices in corporate law reform, while creating an innovative legal regime for MSMEs capable of standing on its own. The structure envisioned in this text is thus neither dependent upon nor specifically linked to existing partnership, corporation or company law in any State.

16. One clear advantage of that approach is that it enables States to more easily adopt a regime that implements the legislative recommendations. Perhaps more important, however, is that this approach permits States to craft appropriate legislative measures using a clean slate method, allowing them to step away from existing legal business forms and respond to the real needs of the types of businesses that such a structure seeks to serve. Such businesses are mainly the micro and small businesses around the world for which strong reliance on human capital rather than organizational processes, limited source and number of employees (usually drawn from family and friends), limited range of products or services offered to customers and limited capital usually represent the main characteristics. The recommendations in the guide create a legal business form that moves away from more traditional, hierarchical and formal governance models towards less rigid and formalistic structures based on the actual needs and expectations of entrepreneurs.

17. Further, in addition to reducing barriers to MSMEs and helping them to maximize their economic potential, the simplification of business incorporation could have additional international effects. In particular, the adoption of a stand-alone simplified business entity regime could facilitate cross-border trade for MSMEs, since it would provide internationally recognized standards for States aiming to develop effective new legal forms for those businesses.<sup>13</sup>

18. In pursuit of this informed and innovative approach to MSME law reform, the Guide has adopted terminology that is intended to be as neutral as possible. In order to consider existing company law solutions but not to rely on their more prescriptive rules, “corporate” and “company” terminology is not used. Instead, this guide describes a new entity: the “UNCITRAL Limited Liability Organisation” (the “UNLLO”).<sup>14</sup> The term is an indication that the business form created through the guide’s recommendations is innovative and independent from existing company law regimes and their more prescriptive rules. The creation of the UNLLO aims to fulfil the desired goals and considerations outlined above.<sup>15</sup>

#### **Note to the Working Group**

##### **(I) Formation document and members' agreement**

**The Secretariat suggests:**

**(a) Requiring the members' agreement to be recorded, as it will be challenging for members of an UNLLO to prove the content of the members' agreement, and the deviations from the default rules provided in this Guide, when the members' agreements are made orally or implied by course of conduct;**

<sup>12</sup> As agreed by the Working Group at its twenty-fourth session (para. 54, A/CN.9/831). See, also different approaches to legal reform as outlined in paras. 5 to 7 of A/CN.9/WG.I/WP.82.

<sup>13</sup> See the Note by the UNCITRAL Secretariat, A/CN.9/780.

<sup>14</sup> At its twenty-seventh session, the Working Group agreed to use the term “UNLLO” on an interim basis until it could decide on a preferred term to denote the simplified business entity being discussed (para. 43, A/CN.9/895).

<sup>15</sup> The Secretariat has merged paras. 25 and 26 of A/CN.9/WG.I/WP.112 and revised their drafting for improved clarity of the text.

(b) *That a members' agreement for a single-member UNLLO would not be necessary (particularly in the case of a single-member UNLLO where the member is also the manager). If the Working Group reaches consensus that such an agreement would be necessary, it might require different features than the members' agreement in a multi-member UNLLO; and*

(c) *Eliminating references to formation document throughout the legislative guide when references were made to information to be submitted upon formation of the UNLLO. Instead reference could be made to the information itself that would be required upon registration. The Secretariat has proposed a definition for "formation data" and has eliminated that of "formation document." Such an approach may not only resolve the ambiguity between the formation document and the members' agreement but may also be helpful when considering the information that would be made public.*

*The Working Group may wish to recall that, at its twenty-fourth session, differences between "formation document" and "members' agreement" (then referred to as an "operating document") were discussed. An "operating document" was intended to be the document or electronic record that governed the affairs of the simplified business entity, and would include articles of association, bylaws and other similar instruments, while the "formation document" was the instrument necessary to create the simplified business entity, the contents of which would be submitted to the business register and would be made public. (para. 39, A/CN.9/831).*

*During the twenty-fourth session, it was observed that an operating document might consist of an oral agreement. (para. 52, A/CN.9/831).*

*When the Working Group next considered the Legislative Guide on an UNCITRAL Limited Liability Organisation, at its twenty-seventh session, the Secretariat had incorporated reference to oral agreement and to agreement by conduct into then recommendation 11 (rec. 10 of the current guide) (see para. 2, A/CN.9/WG.I/WP.99/Add.1), which was not discussed by the Working Group.*

*Similarly, the recommendation was not considered at the Working Group's thirty-first session (see para. 65, A/CN.9/WG.I/WP.112). However, it was noted that the phrase "members' agreement" as generally agreed upon in recommendation 11 should contain bracket as the Working Group had not reached consensus on the use of "members' agreement" or "formation document". If "members' agreement" was to be used, the Working Group would need to consider whether such an agreement would need to be recorded. The Working Group agreed it would review the definition of "members' agreement" more generally.*

## **(2) Shares**

*The Working Group may wish to provide guidance on the rights that are created by a share, as these rights could encompass both financial rights and decision-making rights. The Guide could elaborate on financial rights that are created by a share, including the member's right/duty to share in the profits, losses, and distributions.*

*In addition, if decision-making rights are established in proportion to a member's share, the Working Group may wish to identify in each section of the legislative guide whether majority and qualified majority should be determined by number or by share.*

## **(3) Ordinary course of business**

*At its thirty-first session, it was pointed out that the difference between decisions taken in the ordinary course of business and decisions taken outside the ordinary course of business may add ambiguity to the text, which would need to be explained in greater detail (para. 50, A/CN.9/963).*

*To make the guide as widely applicable as possible, and given that a definition to ordinary course of business may result in an overly prescriptive approach to management, the Secretariat has not included "ordinary course of business" in the terminology section. Instead the legislative guide provides particular attention to*

*instances when matters would fall outside of that scope, and provides reference to recommendations 22 to 24.*

## B. Terminology<sup>16</sup>

19. The following terms are intended to provide orientation to the reader of the legislative guide. An explanation of their use in the legislative guide may assist in ensuring that the concepts discussed are clear and widely understood.<sup>17</sup> It should be noted that whenever terms such as data, documents, agreements (including members' agreements), tax returns, financial statements, records and other similar expressions are used, reference is intended to include both their electronic and paper versions unless otherwise indicated in the text.

- *Financial statement*: “Financial statement” means the report that presents information on the financial activities and conditions of the UNLLO.
- *Formation data*: “Formation data” means the information that must be submitted to the designated State authority in order to create the UNLLO.<sup>18</sup>
- *Designated manager*: “designated manager” means the person or persons responsible for managing the UNLLO when the UNLLO is not managed by all of its members exclusively.<sup>19</sup> A “designated manager” can be either a non-member or a member of the UNLLO or some combination thereof.<sup>20</sup>
- *Member(s)*: “Member(s)” means the owner(s) of the UNLLO (cf. “UNLLO”).
- *[Members' agreement]*: “Members' agreement” means the recorded rules that govern the organization of the UNLLO.<sup>21</sup>
- *Qualified majority*: “Qualified majority” means [percentage to be included subject to the Working Group decision] of the UNLLO members.<sup>22</sup>
- *Share*: “share” means the ownership stake of an UNLLO that a member has. It includes the member's financial stake in the profits and losses of the UNLLO and the right to receive distributions, as well as the decision-making rights to participate in the management and control of the UNLLO.<sup>23</sup>
- *UNCITRAL limited liability organisation [UNLLO]*:<sup>24</sup> “UNCITRAL limited liability organisation [UNLLO]” means the legal business form with limited liability and legal personality discussed in the legislative guide.

<sup>16</sup> The Secretariat has added a “Terminology” section further to a request of the Working Group at its twenty-seventh session (para. 19, [A/CN.9/895](#)).

<sup>17</sup> The Secretariat has revised para. 19 (para. 27 of [A/CN.9/WG.I/WP.112](#)) for greater clarity of the text.

<sup>18</sup> The Secretariat has replaced “formation document” with “formation data” for the reasons explained in the Note before para. 19.

<sup>19</sup> For improved clarity, the Secretariat has replaced “member-managed” with “managed by all of its members exclusively” (or a variation thereof) throughout the text.

<sup>20</sup> The Secretariat has revised the definition of “manager” further to a request of the Working Group at its thirty-first session, (para. 68, [A/CN.9/963](#)).

<sup>21</sup> At its thirty-first session, the Working Group agreed it would review the definition of member's agreement more generally (para. 45, [A/CN.9/963](#)). The Secretariat suggests a new definition of “members' agreement” that emphasizes the fact that such agreement should be recorded, consistent with the Note to the Working Group that precedes this paragraph.

<sup>22</sup> At its thirty-first session, the Working Group agreed to define “qualified majority” at its future sessions (para. 68, [A/CN.9/963](#)). The Secretariat has simplified the text of the definition as it appeared in [A/CN.9/WG.I/WP.112](#).

<sup>23</sup> At its thirty-first session, the Working Group agreed that the term “ownership” as used in [A/CN.9/WG.I/WP.112](#) had primarily economic implications and that “share” would better indicate the concept of membership in the UNLLO (para. 77, [A/CN.9/963](#)). The Secretariat has made that replacement in the Terminology section and throughout the guide.

<sup>24</sup> The Working Group may wish to note that the term “UNLLO” is defined only in order to facilitate consideration of these materials, in accordance with the Working Group decision that such term be used on an interim basis (see *supra* footnote 14).

## II. Establishment and operation of the UNLLO

### A. General provisions

#### (a) Legislative framework

20. As noted above (see para. 15), the approach taken in this legislative guide is to create a legal business form that does not depend on and is not specifically linked to any existing law in an enacting State<sup>25</sup> for its establishment, definition or operation. Instead, the UNLLO is intended to be a distinct product of legislation that has been prepared on the basis of the recommendations in the legislative guide.<sup>26</sup>

21. Although the legal forms for privately held businesses may vary from State to State, one of their hallmarks is that they tend to function as independently as possible from the strict rules that govern corporations. For example, privately held businesses tend to have specific relief from the rules governing public companies, resulting in: simpler formation rules; nominal or no minimum capital requirement; greater freedom of contract; and fewer disclosure requirements.

#### (b) Flexibility through freedom of contract

22. The main focus of legislative reforms to assist the creation of privately held business entities to date has been on the creation of flexible business forms that can be tailored to the needs of certain types of closely held businesses, including: MSMEs wishing to formalize and segregate personal and business assets; family firms; joint ventures; and professional service firms. In some States, reforms have resulted in legislative models that permit the separation of the business assets of an entity from the personal assets of its members without resort to legal personality. This would allow asset partitioning for MSMEs and their members by way of a legal structure that stops short of full limited liability and legal personality.<sup>27</sup>

23. The UNLLO is intended to be added to this list of flexible business forms. The flexibility in business form has been achieved in part by allowing the UNLLO to be organized for a wide range of activities (see paras. 27 and 28 and rec. 2 below) and by recognizing the importance of freedom of contract for these privately held businesses. In this respect, freedom of contract has been made the guiding principle in establishing the internal organization of the UNLLO (see paras. 55 and 56 below).<sup>28</sup>

24. The legislative guide permits the members of the business to agree through contractual mechanisms (i.e. members' agreement) on the internal governance of the enterprise, to contract around the more superfluous and cumbersome protective requirements traditionally associated with public companies, and to tailor rights and duties that are more consistent with the needs of smaller businesses.

25. However, the legislative guide also includes certain recommendations for mandatory rules that cannot be contracted out of by agreement among the members,

<sup>25</sup> At its twenty-seventh session, the Working Group agreed that it would revert to discussion on linkage of the legislative guide to existing domestic company law at a later stage (para. 22, [A/CN.9/895](#)).

<sup>26</sup> The Secretariat has deleted the final phrase of this paragraph (para. 25 of [A/CN.9/WG.I/WP.99](#)), "and which ... enacting State", to eliminate redundancy in the text.

<sup>27</sup> At its twenty-seventh session, the Working Group agreed to move the second sentence of para. 37 of [A/CN.9/WG.I/WP.99](#) ("However, it should be noted ... legal personality.") to a more appropriate section of the legislative guide and to delete the phrase "limited liability" after "without resort to legal personality" (paras. 31 and 32, [A/CN.9/895](#)). The Secretariat has relocated that sentence in para. 23 above, with additional editorial adjustments.

<sup>28</sup> In that regard, the Working Group has observed that MSMEs could find it difficult to establish such rules, and that standard forms could be useful to assist such businesses (see para. 63, [A/CN.9/800](#), para. 23 of [A/CN.9/WG.I/WP.86](#) and para. 58, [A/CN.9/963](#)). Once the Working Group has advanced its work on the legislative guide, it may thus wish to consider whether it would be useful to prepare such standard form members' agreements to assist MSMEs in this regard.

as well as default provisions to fill any gaps in their agreement. These default rules can be particularly important for smaller or less-experienced business persons who may not foresee every eventuality required for the successful operation of the UNLLO.<sup>29</sup>

26. The fact that the UNLLO is established through an independent legislative approach on the basis of the recommendations contained in the legislative guide that permits extensive freedom of contract to organize the UNLLO's operations is reflected in recommendation 1.

**Recommendation 1: The law should provide that an UNCITRAL Limited Liability Organisation (“UNLLO”) is governed by [this law] and by the members’ agreement.<sup>30</sup>**

27. Recommendation 2 permits an UNLLO to be organized for any lawful business or commercial activity. A very broad approach is taken to the permitted activity of an UNLLO in order to provide maximum flexibility to the MSMEs that it is anticipated will use this business form. In keeping with the traditional approach of UNCITRAL texts, the guide supports the view that States should give the terms “commercial” and “business” broad interpretation to avoid unwarranted narrowing of the permitted scope of the UNLLO.<sup>31</sup> Moreover, the legislative guide follows the approach adopted by several legislative reforms of excluding the use of general purpose clauses so that business entities can engage in all lawful activities under the law of the State. The legislative guide thus leaves it open to the members of the UNLLO to decide whether or not they wish to include a more restrictive purpose clause in the members’ agreement. States requiring business entities to list all of their activities may wish to consider removing that requirement for UNLLOs.

28. States wishing to prohibit an UNLLO from engaging in certain regulated industries, such as banking, microcredit and insurance industries, could enumerate the industrial sectors and activities in which an UNLLO may not participate. For additional clarity, States may expressly permit participation of the UNLLO in specific activities which might include activities in the agricultural, artisanal and cultural sectors.<sup>32</sup>

**Recommendation 2: The law should provide that an UNLLO may be organized for any lawful business or commercial<sup>33</sup> activity.**

29. The legislative guide recommends the granting of legal personality to the UNLLO in order for it to be a legal entity separate from its members.<sup>34</sup> Legal personality in this context confers upon the UNLLO the legal rights and duties necessary for it to function within a legal system, including the ability to acquire rights and assume obligations in its own name.

<sup>29</sup> The Secretariat has revised paras. 22 to 26 of the guide (paras. 27 to 30 of [A/CN.9/WG.I/WP.99](#)) for improved clarity of the text.

<sup>30</sup> At its twenty-seventh session, the Working Group agreed to delete “if any” at the end of rec. 1 (para. 24, [A/CN.9/895](#)) and to defer decision on rec. 1 and its commentary until it had considered rec. 10 and the accompanying commentary (para. 28, [A/CN.9/895](#)). See also infra footnote 91. The Secretariat has placed “this law” in brackets to indicate that this phrase refers to the domestic legislation that will be enacted on the basis of this legislative guide.

<sup>31</sup> The Secretariat has redrafted this paragraph (paras. 31 and 32 of [A/CN.9/WG.I/WP.99](#)) for consistency with revised rec. 2 and further to a request of the Working Group at its twenty-seventh session that the terms “commercial” and “business” should be given a broad interpretation (para. 30. [A/CN.9/895](#)).

<sup>32</sup> The Secretariat has revised the drafting of para. 28 (para. 36 of [A/CN.9/WG.I/WP.112](#)), including by deleting the phrase “or participation...funds”, for improved clarity.

<sup>33</sup> At its twenty-seventh session, the Working Group agreed to insert the phrase “business or commercial” before “activity” (para. 30, [A/CN.9/895](#)).

<sup>34</sup> The Secretariat has revised the opening sentence of para. 29 (para. 37 of [A/CN.9/WG.I/WP.112](#)).

30. Legal personality provides a means through which the UNLLO's assets can be separated from the personal assets of its members, a process which has been referred to as affirmative asset partitioning. A distinct legal personality permits the UNLLO to be shielded from potential claims by the personal creditors of its members. This, in turn, facilitates defensive asset partitioning by an UNLLO that has been granted limited liability, which can then protect the personal assets of the UNLLO members from exposure in the event that the UNLLO is unable to satisfy its debts or meet its obligations or becomes involved in legal disputes.<sup>35</sup> Legal personality and limited liability protection (see rec. 4) thus provide a convenient legal mechanism for the UNLLO to separate its assets from the personal assets of its members.<sup>36</sup>

31. It should be noted that domestic taxation policy in respect of the legal form of an UNLLO is not considered in the legislative guide. Such policy matters are left to States drafting legislation on the basis of this guide, with the understanding that they might consider their policy options in the broader context of how best to reduce legal obstacles for UNLLOs, and MSMEs more generally.

**Recommendation 3: The law should provide that the UNLLO has a legal personality distinct from its members.<sup>37</sup>**

32. Recommendation 4 states one of the essential consequences of conferring legal personality to a business entity, which is that the members of the UNLLO are not personally liable for the obligations and debts of the UNLLO, except in cases of misuse or fraudulent use by the members of the legal personality of the UNLLO.<sup>38</sup> As such, recommendation 4 is a mandatory rule.

33. Limited liability<sup>39</sup> permits entrepreneurs to take business decisions without concern that their personal assets will be jeopardized in the event the business entity does not perform well or becomes involved in legal disputes.<sup>40</sup> This is important both for the protection of the members of the organization and for the promotion of innovation and business creation. However, many MSMEs do not currently enjoy the benefits of limited liability protection. In some States, limited liability protection is not offered to MSMEs because of concerns that it would encourage opportunism by entrepreneurs and provide insufficient protection for third parties dealing with the MSME. Other States, however, grant members of MSMEs access to limited liability protection, since this is considered to promote entrepreneurship and facilitate capital

<sup>35</sup> The Secretariat has shifted the order of the sentences "Such distinct ... legal disputes" as they appeared in [A/CN.9/WG.I/WP.99](#) for improved consistency of the paragraph.

<sup>36</sup> In keeping with deliberations of the Working Group at its twenty-seventh session, the Secretariat has included here (para. 36 of [A/CN.9/WG.I/WP.99](#)) the opening sentence of para. 37 of [A/CN.9/WG.I/WP.99](#). See also *supra*, footnote 27.

<sup>37</sup> At its twenty-seventh session, the Working Group agreed to insert the phrase "distinct ... members" at the end of the recommendation (para. 33, [A/CN.9/895](#)).

<sup>38</sup> In keeping with changes requested by the Working Group at its twenty-seventh session (para. 34(b), [A/CN.9/895](#)), and further to modifications suggested by the Secretariat for consistency with revised rec. 4, para. 32 (para. 40 [A/CN.9/G.I/WP.112](#)) previously read as follows: "Draft recommendation 4 establishes the default rule that members of the UNLLO will enjoy limited liability for the obligations of the UNLLO". The Secretariat, however, suggests a further revision of this paragraph for improved clarity of the concept of limited liability and its relation to legal personality. Moreover, it is suggested that rec. 4 be defined as a mandatory and not a default rule. The Secretariat has included the concept of how members can apportion liability among themselves in para. 75. See also footnote 114 *infra*.

<sup>39</sup> The Working Group may wish to discuss the issue of separating personal assets from assets reserved to the UNLLO in the case of a single-member UNLLO. It would be important to clarify this aspect in respect of those situations when the single-member UNLLO becomes insolvent. In this regard, the Working Group might wish to consider whether, in this section, it would be advisable to keep separate the discussion on a single-member UNLLO and more sophisticated forms of an UNLLO (para. 90, [A/CN.9/963](#)).

<sup>40</sup> The Secretariat has replaced the phrase "in case...failure" after "jeopardize" with the current drafting to better clarify the scope of "limited liability".

formation.<sup>41</sup> As such, and in order to offer this important and attractive feature to such economic actors, the legislative regime establishing the UNLLO offers limited liability protection to UNLLO members.

34. The presence of such a liability shield generally protects the members of an UNLLO from incurring direct or indirect personal liability as a result of the activities of the UNLLO. In effect, the financial liability of a member of the UNLLO is limited to a fixed sum, usually the value of the member's contribution to the UNLLO. As noted above, limited liability of members and distinct legal personality of the organization often go hand in hand (see recs. 3 above and 8 below). Granting both attributes to the UNLLO will assist in promoting the stability of the organization and access by it to lower cost credit.

35. The UNLLO itself is liable to its general creditors and all of the assets of the UNLLO are available to satisfy those claims. In addition, it is important to note that the limitation on the liability of a member for the obligations of the UNLLO refers to liability that results solely from that person's status as a member of the UNLLO. Members of the UNLLO may still have personal liability for personal tort<sup>42</sup> or for example, a member may be liable for a personal guarantee that has been undertaken in respect of the obligations of the UNLLO. Moreover, in the event that a contract with a third party was entered into before the formation of the UNLLO, members or managers of the UNLLO who entered in that contract may incur personal liability if the third party did not know it was entering into a contract with an UNLLO. For these instances, the law should permit a reasonable time period for subsequent action by the members to cure the lack of legal formation and to alert third parties of the change in legal status.<sup>43</sup>

36. Of course, it will remain open for courts to lift the limited liability protection and impose personal liability on members and managers in cases of fraud or other wrongful acts committed in the name of the UNLLO ("piercing the corporate veil").<sup>44</sup> Such abuse of the UNLLO legal form could arise, for example, where a member makes use of UNLLO assets as though they were that member's personal assets.

**Recommendation 4: The law should provide that a member is not personally liable for the obligations of the UNLLO solely by reason of being a member of that UNLLO.<sup>45</sup>**

37. Some States maintain the view that a minimum capital requirement is a reasonable quid pro quo for members of a privately held business to receive the benefit of limited liability protection. However, many of those States have significantly reduced minimum capital requirements for these businesses to nominal or initially low but progressively increasing amounts. It has been suggested that even in a nominal or progressive form minimum capital requirements can be conducive to business growth, since they function not only to protect third parties, but also to assist

<sup>41</sup> The Secretariat has added the sentences "In some States ... capital formation" to the paragraph (para. 39 of A/CN.9/WG.I/WP.99) for improved clarity of the text.

<sup>42</sup> At its twenty-seventh session, the Working Group agreed to delete the phrase "or liability ... UNLLO", before "or for example", since it concerned liability matters of a different nature from those discussed in this paragraph (para. 34(a), A/CN.9/895).

<sup>43</sup> At its twenty-seventh session, the Working Group agreed to include in the commentary a discussion in respect of contracts entered into prior to the legal formation of the UNLLO (para. 51, A/CN.9/895). The Working Group may wish to consider whether an additional recommendation and attendant commentary could be added in this part of the guide to address the legal consequences on the UNLLO and its members' liability for contracts and other acts that a member-to-be concludes or performs for the benefit of the UNLLO prior to its formation.

<sup>44</sup> See, also, para. 38(e) in relation to rec. 5, as well as recs. 16, 19 and 20.

<sup>45</sup> At its twenty-seventh session, the Working Group agreed to retain the text of rec 4.1 and to delete rec. 4.2 as they appeared in footnote 37 of A/CN.9/WG.I/WP.99, but to reflect the content of proposed rec. 4.2 elsewhere in the text possibly in relation to the members' agreement (para. 37, A/CN.9/895). The Secretariat has implemented that suggestion in para. 75 of the current revision.

in terms of the soundness, effectiveness and productivity of the business and provide information in respect of financial and decision-making rights.<sup>46</sup> On the other hand, concerns have been raised that capital requirements, including progressive capital requirements, could have a negative impact upon small start-up enterprises. The first three years of an enterprise's life cycle are the most critical and yet it would be required to progressively build up its reserves during that period in spite of possible financial fragility.<sup>47</sup> Moreover, since the minimum capital required to create a business, along with the accounting rules of the required capitalization, is often one of the most important considerations for new businesses, its elimination may be a factor that can positively affect the rate of establishment of business entities. Further, as a matter of State policy, one particular problem related to establishing minimum capital requirements is the difficulty of quantifying an appropriate amount, and the rigidity inherent in making such a choice.<sup>48</sup>

38. The issue of minimum capital requirements should be dealt with in the context of general mechanisms for the protection of creditors and other third parties dealing with the UNLLO.<sup>49</sup> The more important of such mechanisms are included in the legislative guide as mandatory rules, while others may be found elsewhere in a State's legislative framework. These mechanisms include:

- (a) Making members of the UNLLO liable for improper distributions and obligating them to repay the UNLLO for any such distributions (see recs. 19 and 20, which are mandatory rules);
- (b) Prescribing standards of conduct, including good faith and fiduciary responsibilities (see rec. 16(a), which is a mandatory rule);
- (c) Requiring transparency and accessibility in the keeping and sharing of UNLLO records and information (see recs. 25 and 26, which are mandatory rules);
- (d) Requiring that the entity's business name contain an indicator of its limited liability status (for example, "UNLLO") and that its name be set out in contracts, invoices and other dealings with third parties (see rec. 6, which is a mandatory rule);
- (e) Permitting exceptions to the limited liability protection of members of the UNLLO in certain circumstances (a rule on "piercing the corporate veil" is a judicial remedy in respect of corporations and other limited liability entities that is available in some States but that should not necessarily be imported as a matter of statute in respect of the UNLLO, where it might better be characterized in terms of mandatory rules prohibiting a member's abuse of the UNLLO legal form; such mandatory rules are found in recs. 16(a), 19 and 20);<sup>50</sup>

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<sup>46</sup> At its thirty-first session, the Working Group suggested that the term "voting rights" could cause confusion in a simplified context such as that of the UNLLO. The Secretariat thus suggests replacing it with "decision-making rights" throughout the text of the guide.

<sup>47</sup> The Secretariat has redrafted this paragraph (para. 44 of A/CN.9/WG.I/WP.99) further to the request of the Working Group at its twenty-seventh session, that the commentary should reflect the considerations raised by the Working Group during its twenty-seventh and previous sessions in regard to policy choices for and against minimum capital requirements (para. 42, A/CN.9/895).

<sup>48</sup> The Secretariat has relocated the sentences "Moreover, since the minimum...such a choice" of para. 46 of A/CN.9/WG.I/WP.112 here and deleted the rest of that paragraph for improved consistency of the text.

<sup>49</sup> The Working Group may wish to consider including this paragraph under a separate section relating to the protection of creditors and other third parties. The Working Group may wish to consider the following aspects for future discussion:

- (a) whether the UNLLO members should be liable to creditors or just to the UNLLO (in case of an abuse of the UNLLO form by the members); and
- (b) whether creditors can force the UNLLO to act against its members.

<sup>50</sup> The Working Group may wish to recall that it has previously considered the issue of "piercing the corporate veil", reaching general agreement that "rules on piercing the corporate veil were quite detailed and could vary widely from State to State, such that it might not be productive to attempt to establish such standards in the text of the guide, outside of noting the potential importance of such a remedy in the commentary and leaving the establishment of standards on it to enacting States." (paras. 56 and 58, A/CN.9/831). In any event, courts may still "pierce the

- (f) Establishing requirements in respect of the transparency, quality and public availability of registered information on the UNLLO and its managers (this could be expected to be a function of the business registry law of a State);<sup>51</sup>
- (g) Establishing a supervisory role for commercial registries or specialized agencies (this could also be expected to be a function of the business registry law of the State);
- (h) Establishing credit bureaux (this would be a policy decision of the State); and
- (i) Requiring corporate governance oversight (this would be a policy decision of the State).

39. In keeping with the nature of the UNLLO as a mechanism to assist MSMEs, as well as several legislative reforms that have replaced the minimal capital requirement with other mechanisms to protect third parties dealing with the UNLLO, the legislative guide does not recommend a minimum capital requirement for the establishment of an UNLLO. As noted above, the main mechanisms included in the legislative guide to provide protection to third parties dealing with the UNLLO are by way of the mandatory rules in recommendations 6, 16(a), 19, 20, 25 and 26, as outlined in subparagraphs 38 (a) to (e) above.

40. Even where a State has policy reasons to require a minimum capital, this guide recommends that such a requirement not be imposed on the UNLLO, even if the amount is nominal or progressively increasing.<sup>52</sup> Instead, other mechanisms may be considered, such as the establishment of a maximum size (for example, based upon the number of employees) or level of profitability of the UNLLO, which could then be required to convert to another legal form (for which the State might require minimum capital) upon exceeding that maximum. It should be noted, however, that these other mechanisms could unnecessarily restrict the growth of UNLLOs.

**Recommendation 5: The law should not require a minimum capital for the formation of an UNLLO.**

41. In order to signal to third parties that they may be dealing with an UNLLO, the law should require the name of the UNLLO to include a phrase or abbreviation (such as “UNLLO”)<sup>53</sup> that would enable it to be distinguished from other types of business entity.<sup>54</sup> The use of the same or a similar phrase or abbreviation in different States would assist UNLLOs engaging in cross-border trade as the defining characteristics of the entity would be immediately ascertainable upon recognition of the phrase or abbreviation, even in the cross-border context. Since the UNLLO legal form is intended as an innovative legal form specifically tailored to MSMEs and created through an independent legislative approach delinked from existing models, the choice of an appropriate identifying phrase or abbreviation need not be dependent on the local legal context.<sup>55</sup>

42. While some States may wish to require the UNLLO to use its distinctive phrase or abbreviation in all correspondence with third parties in order to signal its legal

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“corporate veil” under State law if the UNLLO legal form is abused by its members, and such a tool need not be specifically inserted into the text of the legislative guide. At its twenty-seventh session, the Working Group agreed with the approach outlined in this footnote (para. 35, A/CN.9/895).

<sup>51</sup> See the Guide on Business Registration for relevant recommendations.

<sup>52</sup> The Secretariat has revised the opening sentence of the paragraph (para. 49 of A/CN.9/WG.I/WP.112) for improved clarity.

<sup>53</sup> In keeping with footnotes 14 and 24, *supra*, the term “(“UNLLO”)” is used here by way of example.

<sup>54</sup> The Working Group agreed on this approach at its twenty-seventh (para. 43, A/CN.9/895) and previous sessions (see para. 69, A/CN.9/825 and paras. 61 to 63, A/CN.9/831).

<sup>55</sup> In light of the discussion in the commentary to rec. 6, the Working Group may wish to agree on a suggested unified phrase or abbreviation to be used for the identification of the UNLLO.

personality,<sup>56</sup> an appropriate sanction for failure to do so should be established. Denial of the benefit of limited liability protection for an UNLLO may be too severe. Instead, while encouraging UNLLOs to use this distinctive phrase or abbreviation in all correspondence in order to enhance legal certainty, States may decide not to make it mandatory so as to avoid creating an additional burden on the UNLLO by potentially increasing its administrative costs of compliance and verification. Practically speaking, since the distinctive phrase or abbreviation forms part of the name of the UNLLO, it would likely be included in all correspondence involving the UNLLO, in any event.

43. In terms of the name chosen for the UNLLO, all mandatory requirements concerning registration (and approval) of company names in the jurisdiction in which the UNLLO is doing business will have to be satisfied.<sup>57,58</sup>

**Recommendation 6: The law should provide that the name of the UNLLO must include a phrase or abbreviation that identifies it as an UNLLO.**

## B. Formation of the UNLLO

44. The legislative guide takes a flexible approach and recommends that the law should permit an UNLLO to be established and operated by a single member or multiple members. This accommodates the creation of an UNLLO by a sole member, including an individual entrepreneur engaged in relatively simple business activities, and permits the UNLLO to evolve from a single member entity to a more complex multi-member one. In order to protect creditors and third parties dealing with the UNLLO and to provide legal certainty, recommendation 7 establishes that an UNLLO should have at least one member at all times. In the case of a single-member UNLLO, States should consider establishing a reasonable time period for the replacement of the member, if the members' agreement does not contain appropriate provisions in this regard, so as to avoid an automatic dissolution of the UNLLO.<sup>59</sup> As an additional feature to enhance the flexibility of the UNLLO, recommendation 7 does not specify a maximum number of members for the UNLLO.<sup>60</sup>

45. An important issue for States to consider in the legislation establishing the UNLLO is whether a member of an UNLLO may be a legal person or whether only natural persons are permitted membership in an UNLLO. When a legal person is permitted to be a member of the UNLLO, it is desirable that States ensure a wide understanding of the concept of "legal person", which should include any entity that has been granted a legal personality.<sup>61</sup> Permitting a legal person to be a member of an UNLLO may facilitate the transition of the UNLLO to a more sophisticated type of business. Moreover, membership of a legal person in an UNLLO may help the UNLLO access greater resources (monetary, technological, and skill sets) and new

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<sup>56</sup> The Secretariat has replaced "limited liability" in para. 42 above (para. 51 of [A/CN.9/WG.I/WP.112](#)) with "legal personality" to emphasize this distinctive feature of the UNLLO).

<sup>57</sup> Further to a request of the Working Group at its twenty-seventh session, the Secretariat has deleted paras. 50 to 52 of [A/CN.9/WG.I/WP.99](#) (para. 46, [A/CN.9/895](#)).

<sup>58</sup> The Guide on Business Registration discusses registration and prior reservation of business names, the importance of such names being unique, State's criteria on business names requirements and the role of the business registry in assisting entrepreneurs choosing a name for their business.

<sup>59</sup> The Working Group may wish to note that at its thirty-first session consideration of a proposal to delete the sentence "In the case of...the UNLLO" was postponed until after the Working Group had considered section G and rec. 21 on transfer of rights (para. 55, [A/CN.9/963](#)).

<sup>60</sup> For improved consistency of the text, the Secretariat has moved the last sentence of para. 54 of [A/CN.9/WG.I/WP.112](#) to the end of para. 44.

<sup>61</sup> At its thirty-first session, the Working Group agreed to replace the phrase "any legal entity capable of making an investment" with the current drafting ("any entity...legal personality"). The Secretariat has implemented that decision with a minor editorial adjustment for improved clarity (para. 30, [A/CN.9/963](#)).

markets, as well as build credibility. This will be valuable not only for UNLLOs operating in States with lower levels of infrastructure, but also for UNLLOs aiming to expand their activities in the domestic market and abroad.

46. However, States may wish to limit membership in an UNLLO to only natural persons, particularly in the case of a single member UNLLO, which might raise concerns in respect of the integrity and the reliability of the legal form of the UNLLO<sup>62</sup> (see also para. 59 below), since it might increase the risk of money-laundering, fraud or other illicit behaviour. If legal persons are permitted to be members of UNLLOs, States should introduce appropriate safeguards to prevent those illicit activities. For example, they could establish that only natural persons can be appointed as managers of an UNLLO, or that the UNLLO be required to maintain information on the identity of the members and managers of the legal person and any changes thereof or a legal person might be granted membership only in a multi-member UNLLO where the other members are natural persons. All those measures may help prevent the creation of an UNLLO without active business operations (a “shell organization”).

47. In order to preserve the simplicity of the UNLLO, however, this legislative guide leaves States the option to permit only natural persons to become members of an UNLLO.<sup>63</sup>

**Recommendation 7:<sup>64</sup> The law should:**

- (a) **Provide that an UNLLO must have at least one member from the time of its formation [until its dissolution]; and**
- (b) **Specify whether only natural persons or also legal persons are permitted to be members of an UNLLO.**

48. In order to provide legal certainty as to when the UNLLO comes into existence, the legislative guide recommends that an UNLLO should be formed once it is registered.<sup>65</sup> Through registration with the business registry, the UNLLO acquires its essential attributes, including its legal personality, and limited liability for its members. In the interest of predictability and transparency of registration, it is highly desirable that States specify the moment at which the registration of the business is effective.<sup>66</sup> In keeping with international best practices, as outlined in the UNCITRAL Legislative Guide on Key Principles of a Business Registry (the “UNCITRAL Guide on Business Registration”), the State may wish to specify that legal existence is conferred upon the UNLLO either at the time of the entry of the information on business registration into the registry record or when the application for registration is received by the registry.<sup>67</sup>

49. Regardless of the system used to register an UNLLO (electronic, paper-based or a mixed business registry), upon fulfilling the necessary requirements, the UNLLO

<sup>62</sup> The Secretariat has replaced UNLLO form with “legal form of the UNLLO” to highlight that concerns raised would be in respect to UNLLOs generally, and not to one particular business.

<sup>63</sup> At its thirty-first session, the Working Group agreed to include in para. 55 of A/CN.9/WG.I/WP.112 a discussion on the advantages and drawbacks of an UNLLO membership granted to a legal person. The Secretariat has implemented that decision in paras. 45 and 46 of the current text (para. 28, A/CN.9/963). Moreover, para. 47 (para. 55 of A/CN.9/WG.I/WP.112) has been redrafted for consistency with revised rec. 7(b).

<sup>64</sup> At its thirty-first session the Working Group agreed to redraft rec. 7 to better address States’ concerns of legal persons being members of an UNLLO and to divide the recommendation into two (para. 27, A/CN.9/963). The Working Group might wish to note that it agreed to postpone consideration of a proposal to remove the phrase “until its dissolution” in rec. 7(a) to a later stage (para. 55, A/CN.9/963).

<sup>65</sup> The Secretariat has revised the opening sentence of para. 48 (para. 56 of A/CN.9/WG.I/WP.112) for consistency with the revised rec. 8 (para. 31, A/CN.9/963).

<sup>66</sup> See the Guide on Business Registration paras. 142 ff.

<sup>67</sup> The Secretariat has modified this paragraph (para. 56 of A/CN.9/WG.I/WP.112) for consistency with redrafted rec. 8 and the Guide on Business Registration (para. 31, A/CN.9/963).

should receive a notice of registration from the designated State authority. In keeping with the recommendations of the Guide on Business Registration and in order to accommodate the simple nature of the UNLLO, issuance of the notice of registration should be as fast and as streamlined as possible.<sup>68</sup>

**Recommendation 8: The law should provide that the UNLLO is formed once it is registered.<sup>69</sup>**

50. Depending on the type of business entity being created, States typically require different types and amounts of information to be submitted for valid formation.<sup>70</sup> As a reflection of the intended simplicity of the UNLLO, the legislative guide limits the information required for the formation of the UNLLO to the minimum necessary for its establishment and operation, as well as for the protection of third parties. In addition, recommendation 9 respects the principle that it should be as simple as possible for an MSME to provide the formation data required so as to avoid creating unnecessary burdens and to encourage compliance with the law. It is open to the UNLLO to include any additional information deemed appropriate, in particular if such information can assist it in accessing credit or attracting investors.

51. The minimum mandatory information to be submitted for the formation of the UNLLO pursuant to recommendation 9 includes the name of the UNLLO as well as the address at which the business is to be deemed to receive correspondence.<sup>71</sup> Where the business does not have a standard form address, a precise description of its geographic location should be provided instead of the business address.<sup>72</sup> The business address or geographic location of the UNLLO would be used for service or mailing purposes.<sup>73</sup>

52. The identity of each person who manages the business must also be provided for the formation of the UNLLO. If the business is exclusively managed by all of its members (and no external manager), the identity of each member<sup>74</sup> must be included, since each member would be a manager of the UNLLO. If the business is managed by one or more designated managers, whether or not the managers are members of the UNLLO, the identity of each designated manager must be included. Requiring the UNLLO to disclose the identity of each person managing the business provides greater transparency to State authorities and third parties dealing with the UNLLO.<sup>75</sup> Information on the residential address of each of those persons is, however, not required for the formation of the UNLLO;<sup>76</sup> the rationale being that such information

<sup>68</sup> The Secretariat has deleted paragraph 58 of [A/CN.9/WG.I/WP.112](#) for consistency with redrafted rec. 8 and in keeping with the decision of the Working Group at its thirty-first session that the discussion on the registration of the UNLLO should be drafted neutrally and include references to the Guide on Business Registration (para. 32, [A/CN.9/936](#)).

<sup>69</sup> The Secretariat has revised the text of the recommendation as requested by the Working Group at its thirty-first session (para. 31, [A/CN.9/963](#)).

<sup>70</sup> At its thirty-first sessions, the Working Group reiterated its previous deliberations (para. 52, [A/CN.9/895](#)) that the question of what information should be required for the valid formation of the UNLLO should be considered separately from the question of what information should be made public (para. 40, [A/CN.9/963](#)) and that it would return to this aspect at a later stage.

<sup>71</sup> The Secretariat has rephrased the final clause of this sentence for improved consistency with the Guide on Business Registration.

<sup>72</sup> See also rec. 21 of the Guide on Business Registration.

<sup>73</sup> The Secretariat has deleted the final sentence of para. 51 (para. 60 of [A/CN.9/WG.I/WP.112](#)) for consistency with the new draft of rec. 9.

<sup>74</sup> At its thirty-first session, the Working Group agreed to replace “member” with “member-manager” to account for instances where the UNLLO would be managed by only some of its members (para. 33, [A/CN.9/963](#)). The Secretariat has however revised the opening sentences of para. 52 (para. 61 of [A/CN.9/WG.I/WP.112](#)) for improved clarity, it thus suggests retaining the current term “member” to avoid redundancy.

<sup>75</sup> The Secretariat has added this sentence to para. 52 (para. 61 of [A/CN.9/WG.I/WP.112](#)) in keeping with discussion of the Working Group at its thirty-first session on the importance of enabling more precise identification of the UNLLO managers (paras. 35 and 41, [A/CN.9/963](#)).

<sup>76</sup> The Secretariat has replaced “in the formation document” with “for the formation of the UNLLO” for reasons mentioned before para. 18.

is not essential to fulfil the objective of protection of third parties. The business address of the UNLLO, would be sufficient for the State to fulfil that objective and to monitor the management of the business. Moreover, the business address of the UNLLO can also function as the official correspondence address of the persons managing the UNLLO.<sup>77</sup>

53. Depending on the domestic context and needs, States might require other information in addition to that listed in recommendation 9. For example, information on the identity of the founding members of the UNLLO, the members' share of the UNLLO, the authority to represent it and any limitations on the power of managers to bind the UNLLO might be considered of particular relevance by some States for the valid formation of an UNLLO.<sup>78</sup>

54. The legislative guide's approach to the information to be provided by an UNLLO to State authorities would be expected to meet the requirements of international standards on beneficial ownership.<sup>79</sup> These information requirements<sup>80</sup> should thus assuage any concerns that the UNLLO legal form could be misused for illicit purposes, including money-laundering and terrorist financing. Such an approach also strikes an appropriate regulatory balance, since it provides sufficient legal and commercial certainty for the State and for the protection of third parties dealing with the UNLLO.<sup>81</sup>

**Recommendation 9: The law should keep the information required for the formation of the UNLLO to a minimum. Such information should include:<sup>82</sup>**

- (a) The name of the UNLLO;
- (b) The business address or, when the business does not have a standard form address,<sup>83</sup> precise geographical location of the UNLLO; and
- (c) The identity of each person who manages the UNLLO.<sup>84</sup>

<sup>77</sup> The Secretariat has revised the final sentences of para. 52 (para. 61 of A/CN.9/WG.I/WP.112) for greater clarity.

<sup>78</sup> The Secretariat has added this discussion on additional information the States might consider requiring for the valid formation of an UNLLO, as agreed by the Working Group at its thirty-first session (para. 41, A/CN.9/963).

<sup>79</sup> Financial Action Task Force (FATF) Recommendation 24 in respect of transparency and beneficial ownership of legal persons encourages States to conduct comprehensive risk assessments of legal persons and to ensure that all companies are registered in a publicly available company registry. The basic information required is: (a) the company name; (b) proof of incorporation; (c) legal form and status; (d) the address of the registered office; (e) its basic regulating powers; and (f) a list of directors. In addition, companies are required to keep a record of their shareholders or members. (See International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations, Part E on Transparency and Beneficial Ownership of Legal Persons and Arrangements ([www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf)). In addition, it should be recalled that business entities, in order to conduct activities, usually must open bank accounts that require the submission of taxation and other identification numbers, and financial institutions may remain the most suitable parties to prevent and combat money-laundering and other illicit activities. For consideration of these issues by the Working Group, see paras. 27 and 41 of A/CN.9/800 and paras. 47 to 55, of A/CN.9/825, as well as information contained in paras. 26 to 32 of A/CN.9/WG.I/WP.82 and paras. 21 and 26 of A/CN.9/WG.I/WP.89.

<sup>80</sup> See, also, recs. 25 and 26 on record-keeping, inspection and disclosure of UNLLO information to its members.

<sup>81</sup> Further to the request of the Working Group at its thirty-first session, the Secretariat has deleted para. 63 of A/CN.9/WG.I/WP.112 (para. 41, A/CN.9.963).

<sup>82</sup> The Secretariat has amended the chapeau of rec. 9, further to a decision of the Working Group at its thirty-first session (paras. 33 and 37, A/CN.9/963).

<sup>83</sup> The Secretariat has added the phrase "when...form address" for greater clarity of rec. 9(b) and consistency with the Guide on Business Registration.

<sup>84</sup> The Secretariat has deleted rec. 9 (c) in A/CN.9/WG.I/WP.112 and replaced "name" with "identity" in new rec. 9(c) (former rec. 9(d)) as agreed by the Working Group at its thirty-first session (para. 41, A/CN.9/963). Further, the Secretariat has replaced the term "manager" with "person...UNLLO" for improved clarity.

## C. Organization of the UNLLO

55. As noted above in respect of recommendation 1 (see paras. 23, 25 and 26), freedom of contract should be the guiding principle in establishing the internal organization of the UNLLO. As a consequence of that principle, the operation of the UNLLO is governed by the agreement of its members, except for those cases in which the law is mandatory and cannot be modified. The rules that are mandatory are those that establish the necessary legal framework of the UNLLO and provide legal certainty, or those that are necessary to protect the rights of the UNLLO and of third parties dealing with the UNLLO. When the members' agreement is silent on a non-mandatory issue, the provisions in the default rules in the legislative guide are intended to fill any gap.

56. In order to manage the UNLLO fairly, effectively and transparently, members may wish their agreement to include rules at least in respect of the following issues:

- (a) Maintenance of timely records of the members' decisions, both inside and outside of the ordinary course of business of the UNLLO, as well as the form in which those records should be maintained;
- (b) Any requirement in respect of members' meetings, including:
  - (i) their frequency and location, as well as any limitation thereon;
  - (ii) any requirement regarding who can call a meeting;
  - (iii) The means by which a meeting may be held, including whether it may be held by technological means via correspondence;
  - (iv) Any notice period required prior to the holding of a meeting;
  - (v) The form of any notice required for a meeting (for example, whether it must be in writing), and the information (if any) that should be attached to the notice (for example, the UNLLO's financial information); and
  - (vi) Whether waiver of any required notice is permitted and the form that waiver may take; and
- (c) Any decisions that would differ from the default rule of a majority vote for decisions in the ordinary course of business or qualified majority for decisions outside of the ordinary course of business of the UNLLO (see para. 64 below and rec. 12 (c)).<sup>85</sup>

57. This legislative guide takes the view that the members' agreement can be written or oral or established through a course of conduct. The broad flexibility permitted for the form of the members' agreement recognizes that in the case of many MSMEs there may be no formal written agreement, and that, in such cases, members should be able to rely on oral agreements and agreement implied by conduct as well as the default rules established in the legislation. However, it may be in the best interests of members to have a written agreement, since oral members' agreements and agreements implied by conduct are more difficult to prove in the event of a dispute. Where an UNLLO has only one member, the member's agreement will still provide for the internal governance of the UNLLO, and may be in writing or implied by conduct.<sup>86,87</sup>

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<sup>85</sup> The Secretariat has relocated para. 56 (para. 73 of [A/CN.9/WG.I/WP.112](#)) in the commentary to rec. 10 for greater consistency of the text. The Secretariat has also revised the paragraph for improved readability.

<sup>86</sup> For improved clarity of the text the Secretariat has revised the drafting of para. 57 (para. 65 of [A/CN.9/WG.I/WP.112](#)). However, given the rationale presented in the "Note to the Working Group" placed before para. 19, the Secretariat would suggest rethinking the approach of this paragraph and rec. 10.

<sup>87</sup> Once the Working Group has reached consensus on the form of the members' agreement (see also *supra*, footnote 86), it may consider whether a members' agreement for a single-member UNLLO is necessary (particularly in the case of a single-member UNLLO where the member is also the

58. The legislative guide does not require that an UNLLO members' agreement be made public. This approach protects the privacy of members and adds to the ease of the UNLLO's operations by avoiding the need to file amendments with the business registration authorities each time a change is made to the members' agreement. When a members' agreement includes provisions that modify the default rules applicable to the UNLLO, however, notice of such changes to third parties dealing with the UNLLO is required in order to be effective against them (see para. 71 and rec. 15 below).<sup>88</sup>

**Recommendation 10: The law should provide that the members of the UNLLO may adopt a members' agreement in any form, including an agreement that is written, oral or implied by course of conduct. That agreement may address any matter relating to the UNLLO, except issues covered by<sup>89</sup> the mandatory rules set out in recommendations 1, 2, 3, 4, 6, 7, 8, 9, 16(a), [15],<sup>90</sup> 19, 20, 23(c), 25 and 26.<sup>91</sup>**

*[Note to the Working Group: The Secretariat has reorganized the structure of Section D below for improved clarity. The section begins with the default rule on management of the UNLLO (rec. 11), followed by the rule governing the decision-making process in an UNLLO managed exclusively by all of its members (rec. 12). The third part of the section focuses on the UNLLO managed by designated managers (recs. 13 and 14, i.e. rec. 15 in A/CN.9/WG.I/WP.112) and the fourth part deals with provisions that are common to both an UNLLO managed by all of its members exclusively and an UNLLO managed by a designated manager (recs. 15 and 16, i.e. recs. 14 and 13 of A/CN.9/WG.I/WP.112).]*

## D. Management of the UNLLO

59. The management structure of the UNLLO should account for problems that may occur in multi-member privately held companies with a relatively small number of members who have substantial participation in its management and operation, as will likely be the case for most UNLLOs. Appointing an external manager (which is common in public companies) to administer the UNLLO may not fit the governance needs of many privately held companies, particularly when they are micro and small enterprises. Recommendation 11 thus makes an UNLLO exclusively managed by all of its members the default approach.

60. However, the default rule may not be suitable for every UNLLO. For example, there may be instances where a member is not willing or eligible to serve as a manager (see para. 62 below).<sup>92</sup> Therefore recommendation 11 permits members of an UNLLO to agree to a management structure that does not involve all members acting as managers. In such instances, the UNLLO will be managed by a designated manager. Alternative management structures may involve management by: (i) only some of the UNLLO members; (ii) only non-member managers; (iii) a combination of some of the UNLLO members and non-member(s); or (iv) all of the UNLLO members and a

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manager), and if so, whether it might require different features than the members' agreement in a multi-member UNLLO (para. 90, A/CN.9/963).

<sup>88</sup> The Secretariat has added this final sentence to the paragraph to clarify that variation of default rules must always be disclosed in order to have legal effect against third parties.

<sup>89</sup> The Secretariat has revised the beginning of the second sentence of the recommendation ("The members...agreement") with the current drafting ("That agreement...covered by") for improved clarity.

<sup>90</sup> The Secretariat has placed the reference to rec. 15 in square brackets in light of its suggestion that such recommendation should no longer be considered mandatory and thus removed from the list of mandatory rules included in rec. 10, see footnote 109 infra.

<sup>91</sup> At its twenty-seventh session, the Working Group agreed to defer consideration of rec. 10 (rec. 11 in A/CN.9/WG.I/WP.99/Add.1) in order to be able to ascertain correctly the mandatory recommendations (para. 58, A/CN.9/895). See also, *supra*, footnote 30.

<sup>92</sup> The Working Group may wish to provide an additional default rule for instances in which not all members are legally eligible to serve as managers, as rec. 11(b) currently only applies to deviations from the default rule by members' agreement.

non-member(s). Designated managers will manage the ordinary course of business of the UNLLO pursuant to recommendation 14.

61. Where there is only one member of an UNLLO, that member will be the manager, unless the member appoints a manager.

62. Managers of an UNLLO, regardless of whether the UNLLO is managed by all of its members exclusively or by one or more designated managers, must meet the legal requirements (e.g., minimum age, absence of disqualification) established under the domestic law of the State for those in a management role. In this respect, the law should also specify whether a legal person that has been granted membership in an UNLLO can be appointed as a manager (see para. 46 above on protective measures to prevent the misuse of an UNLLO by legal persons). In addition to the requirements established under the law of the State, the members' agreement may prescribe other qualifications a manager of the UNLLO must meet.<sup>93</sup>

**Recommendation 11: The law should provide that:**

- (a) **The UNLLO is managed by all of its members exclusively unless otherwise indicated in the [members' agreement];<sup>94</sup> and**
- (b) **Members of the UNLLO may agree in their [members' agreement] to appoint one or more designated managers.<sup>95</sup>**

**1. When the UNLLO is managed by all of its members exclusively**

63. When the UNLLO is managed by all of its members exclusively, the members will have joint and equal management and decision-making rights, unless they agree otherwise in the members' agreement.<sup>96</sup>

64. Further, unless there is agreement to the contrary, differences that arise between members in the ordinary course of business of the UNLLO would be resolved by a majority of its members, and decisions that are outside of the ordinary course of business of the UNLLO would require the approval by [qualified majority] of its members. Decisions outside of the ordinary course of business will include, at a minimum, decisions relating to dissolution and winding-up of the UNLLO, its conversion to another business form, or changing its management structure from an entity managed by all of its members exclusively to one managed by one or more designated managers, or vice versa (see recs. 22 to 24 for decisions on matters outside the ordinary course of business). In this regard, it should be noted that the removal of management duties of one member in an UNLLO managed by all of its members exclusively should require a [qualified majority], as that decision would affect the management structure of the UNLLO, although it would not affect the share of

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<sup>93</sup> The Secretariat has modified the commentary to rec. 11 to make it align with the changes in the recommendation. Further, in keeping with a decision of the Working Group at its thirty-first session, the Secretariat has added a new paragraph (para. 62) on the approach to follow in establishing the requirements to be met in order to be a manager (para. 47, A/CN.9/963).

<sup>94</sup> At its thirty-first session, the Working Group agreed that the phrase "members' agreement" as generally agreed upon in rec. 11 should contain brackets, until consensus was reached on the use of "members' agreement" or "formation document". The Secretariat has implemented that change accordingly and identified other appropriate instances for the consideration of the Working Group (see the Note before para. 19). Moreover, the Working Group agreed to: (a) consider whether the "member's agreement" would need to be recorded, if the term "members' agreement" was to be used; and (b) review the definition of "members' agreement" more generally (para. 45, A/CN.963).

<sup>95</sup> Depending on the outcome of the deliberation on members' agreement/formation document, the Working Group may wish to consider the elimination of recommendation 11b, and the Secretariat would suggest that rec. 11 should be redrafted along the lines of: "the UNLLO is managed by all of its members unless the [members' agreement] indicates a different management structure."

<sup>96</sup> The Secretariat has deleted the final sentence of para. 63 (para. 71 of A/CN.9/WG.I/WP.112) in keeping with redrafted rec. 12.

the UNLLO of the member whose management duties have been removed.<sup>97</sup> Recommendation 12 reflects the default approach to members' decisions on matters in the ordinary course of business of the UNLLO.

**Recommendation 12: The law should provide that when the UNLLO is managed by all of its members exclusively and unless otherwise stipulated in the member's agreement:**

- (a) The members of the UNLLO have joint and equal rights to decide on matters concerning the activities and affairs of the UNLLO;
- (b) Differences among members on matters concerning the ordinary course of activities and affairs of the UNLLO should be resolved by a [majority] decision of the members; and
- (c) Differences among members on matters outside the ordinary course of business should be resolved by [qualified majority].<sup>98</sup>

## 2. When the UNLLO is managed by one or more designated managers

65. As noted above (see paras. 59 to 62), members of an UNLLO may agree on a management structure that differs from the default rule in recommendation 11(a). When members agree on an alternative management structure, the members' agreement should include rules for the appointment and removal of a designated manager. In the absence of such rules,<sup>99</sup> recommendation 13 provides that such decisions should be made by a majority of the members.

66. Should a designated manager<sup>100</sup> become unavailable (through death or otherwise), the members could<sup>101</sup> be required to appoint another manager under the terms of the [members' agreement], and to list the identity of the manager pursuant to recommendation 9(c). Appointing another manager could be important to ensure continuity of the regular operations of the UNLLO.<sup>102</sup>

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<sup>97</sup> The Secretariat suggests inclusion of this last sentence ("In this regard...of the UNLLO") in response to concerns expressed by the Working Group at its thirty-first session on the approach to follow in case of removal of a member-manager in an UNLLO managed by all of its members exclusively (para. 71, [A/CN.9/963](#)).

<sup>98</sup> At its thirty-first session the Working Group discussed different proposals on the substance of rec.12 and agreed to reconsider them at its next session (see paras. 48 to 69 and Annex, [A/CN.9/963](#)). The Secretariat is mindful of the proposed approach it however suggests a revised text of the recommendation for consideration by the Working Group based on previous versions of this draft working paper. The Secretariat is also mindful that at the thirty-first session there was support for a suggestion that rec. 12 should identify the types of issues requiring a [qualified majority] (para. 61, [A/CN.9/963](#)). The Secretariat, however, recommends a different approach in order to avoid duplication with recs. 22 to 24 which provide for a list of matters that fall outside the scope of the ordinary course of business and in light of the fact that the list of instances in para. 64 is a non-exhaustive list that might be further specified by the Working Group at future sessions (para. 63, [A/CN.9/895](#)).

<sup>99</sup> The Secretariat has replaced "agreement" with "rules" in keeping with a suggestion of the Working Group at its thirty -first session (para. 75, [A/CN.9/963](#)).

<sup>100</sup> The Secretariat has replaced manager-managed with the defined term "designated manager" (or "designated managers") throughout the text.

<sup>101</sup> The Secretariat has replaced "would" with "could" in keeping with a suggestion of the Working Group at its thirty-first session (para. 75, [A/CN.9/963](#)).

<sup>102</sup> The Secretariat has replaced the phrase "amendments...be made" in para. 65 (para. 83 of [A/CN.9/WG.I/WP.112](#)) with the current drafting, further to a decision of the Working Group at its thirty-first session that discussion on managers' right to amend the formation document should not be included in the commentary (paras. 34 and 41, [A/CN.9/963](#)).

**Recommendation 13: The law should provide that, unless otherwise agreed in the members' agreement, one or more designated manager(s) may be appointed<sup>103</sup> and removed by a majority decision<sup>104</sup> of the members.**

67. Even when members of the UNLLO appoint one or more designated manager(s) to administer and control the business, members will retain the authority to decide on certain enumerated matters such as those outlined in recommendations 22 to 24. Usually, matters outside the ordinary course of the business will be decided by the members (see para. 64 above), while decisions on any other matter will be made by the designated manager(s), unless otherwise stipulated in the members' agreement. To facilitate the operation of the UNLLO, it would be desirable for the members' agreement to specify which matters are retained for decision-making by members. When the members' agreement is silent, the default rule of recommendation 14 (a) will apply.

68. It will also be desirable for the members' agreement to establish how differences arising among managers on matters within their authority should be resolved. In the absence of such rules, recommendation 14(b) provides that differences should be decided by a majority of the managers.<sup>105</sup>

**Recommendation 14: The law should provide that when the UNLLO is managed by one or more designated manager(s):**

- (a) Managers are responsible for all matters that are not retained by the members of the UNLLO pursuant to the [this law] or the members' agreement; and
- (b) Differences among managers should be resolved by a [majority] decision of the managers, unless otherwise stipulated in the members' agreement.<sup>106</sup>

*[The Working Group may wish to further discuss in the commentary to sub-section 3 how the UNLLO could properly provide notice of limitation of managers' authority to third parties and consider whether an ad hoc recommendation could be desirable.]*

### 3. Provisions applicable to all managers regardless of the management structure of the UNLLO

69. Regardless of whether an UNLLO is managed by all of its members exclusively by one or more designated managers, the legislative guide applies certain provisions, such as the power to act on behalf of the UNLLO and fiduciary duties, to all managers. This approach is reflected in recommendations 15 and 16.

70. Each manager of the UNLLO has the authority to act on behalf of the UNLLO and legally bind it. Restrictions may be agreed upon in the members' agreement in

<sup>103</sup> The Secretariat has replaced "elected" with "appointed" further to a suggestion of the Working Group at its thirty-first session (para. 75, A/CN.9/963).

<sup>104</sup> The Working Group may wish to consider whether a decision per rec. 13 would be determined by majority of share or numbers.

<sup>105</sup> The Secretariat has added new paras. 67 and 68 in support to the new rec. 14.

<sup>106</sup> Pursuant to the deliberations of the Working Group at its thirty-first session, the Secretariat has added a new recommendation (rec. 14) which considers instances where the UNLLO would be managed by designated managers. In this new recommendation, the Secretariat has taken the approach that members would retain decision-making authority over certain extraordinary matters and has drafted the rest of the recommendation in line with the freedom of contract principle that has formed the basis of this guide. Under this approach, the decision-making rights of members would be emphasized but managers would be provided with authority over day to day operations (paras. 62 to 64, A/CN.9/963). For the reasons identified in footnote 30, supra, "this law" has been placed in brackets.

respect of the extent of each manager's authority<sup>107</sup> to bind the UNLLO (for example, only up to a certain monetary threshold), or to vary the default rule that each manager has the authority to legally bind the UNLLO. Such modifications of the default rules will be effective between the members of the UNLLO.

71. However, such restrictions or variations will not be effective against third parties dealing with the UNLLO unless those third parties have notice of that restriction or variation of the manager's authority. If third parties dealing with the UNLLO do not have notice of any limitation that a members' agreement has placed on the authority of a manager, the UNLLO will nonetheless be bound by a decision of that manager, regardless of whether that decision exceeds the manager's authority as limited by the members' agreement.

**Recommendation 15: The law should provide that each manager individually has the authority to bind the UNLLO unless otherwise agreed. Restrictions upon that authority will not be effective against third parties dealing with the UNLLO<sup>108</sup> without proper notice.<sup>109</sup>**

72. The authority to represent and bind the UNLLO must be contained within broad standards of conduct that reduce the risk of managers acting opportunistically while also encouraging managers to act in favour of promoting the welfare of the UNLLO, and, indirectly, its members. Fiduciary duties offer protection against a manager's and fellow member's pursuit of personal interest and any grossly negligent behaviour on their part.<sup>110</sup> Such duties may be separated into: (a) a duty of care; (b) a duty of loyalty, including a duty to refrain from self-dealing transactions, personal use of business assets, usurpation of business opportunities, and competition with the UNLLO; (c) a duty to disclose information to all members of the UNLLO;<sup>111</sup> and (d) a duty of good faith and fair dealing. While the legislative guide is not modelled on any specific legal tradition, the inclusion of such duties tends to be a standard feature of business associations law; for example, fiduciary duties are found in many of the simplified corporate forms resulting from States' reforms in this domain.<sup>112</sup>

73. Claims of breach of fiduciary duties should not be made ex post facto to subject the business judgment to criticism, when managers, in the performance of their official duties, make a good faith decision believed to be in the best interest of the UNLLO.

74. The rule establishing a manager's duties in recommendation 16(a) is mandatory and cannot be varied or eliminated by agreement. No internal agreement could eliminate or limit the liability of a manager: (a) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; or (b) for any transaction from which the manager derived an improper personal benefit.

75. Members could, however, agree to include in their members' agreement a provision that they do not owe fiduciary duties to each other.<sup>113</sup> Similarly, they could

<sup>107</sup> The Secretariat has replaced "to which... the UNLLO" in para. 80 of A/CN.9/WG.I/WP.112 with "each manager's authority" for improved clarity of the text.

<sup>108</sup> In keeping with proposals made at the thirty-first session of the Working Group, the Secretariat has deleted the phrase "in the...business" between "UNLLO" and "without" (see Annex to A/CN.9/963) as well as in the attendant commentary.

<sup>109</sup> The Working Group may wish to further discuss how the UNLLO could properly provide notice. Given that the commentary to rec. 15 permits members of the UNLLO to deviate from the default rule, the Secretariat has added the phrase "unless otherwise agreed." in the text of the recommendation. The Working Group may wish to remove rec. 15 from the list of mandatory rules when it considers rec. 10, see also *supra*, footnote 90.

<sup>110</sup> The Secretariat has relocated this sentence ("Fiduciary duties...their part") here from para. 73 (para. 75 of A/CN.9/WG.I/WP.112).

<sup>111</sup> See also, para. 111 and rec. 25 of this text for more details on the duty to disclose.

<sup>112</sup> At its twenty-eighth session, the Working Group agreed to continue to use "fiduciary duty" in the legislative guide, but suggested to note that the term was not intended to import law from one legal tradition into another (para. 147, A/CN.9/900).

<sup>113</sup> See, *infra*, footnote 119.

agree among themselves how to apportion liability or whether to forego limited liability protection.<sup>114</sup> Members can also agree that a manager must adhere to a standard that is higher than that established in recommendation 16(a).

76. Finally, members may specify in their members' agreement that certain activities are permitted for managers which do not constitute a breach of the duties established in recommendation 16(a).<sup>115</sup> Permitting freedom of contract of the members to this extent could be useful in the context of UNLLOs, since it would allow members to derogate from a prescriptive corporate legal framework which may not be necessary, while still requiring appropriate protection for the UNLLO, its members and third parties dealing with it.<sup>116</sup>

77. Legal claims against managers or members in breach of their fiduciary duties may be brought directly before a court or by way of an alternative dispute settlement mechanism (see rec. 27). Generally, it will be the UNLLO itself, rather than an individual member, that would have a cause of action for a breach of a fiduciary duty by a member or manager. Ordinarily, the manager would be responsible for bringing an action on behalf of the UNLLO. However, in instances in which the manager has breached its own fiduciary duty, a member should have the right to bring a derivative claim on behalf of the UNLLO. In doing so, the member must fairly and adequately represent the other similarly situated members.<sup>117</sup>

**Recommendation 16: The law should provide that:**

- (a) Any manager of the UNLLO owes: (i) a duty of care; (ii) a duty of loyalty; (iii) a duty to disclose information to all members of the UNLLO;<sup>118</sup> and (iv) a duty of good faith and fair dealing; and
- (b) Unless otherwise stated in the member's agreement, fiduciary duties also apply to members of the UNLLO.<sup>119,120</sup>

*[Note to the Working Group: The Working Group may wish to consider providing an additional discussion in Section E on the separation of personal assets from business assets with regard to contributions to the UNLLO in the case of a single-member UNLLO (para. 90, A/CN.9/963). The Working Group may also wish to consider including a practical rule on non-monetary valuations in the legislative*

<sup>114</sup> At its twenty-seventh session, the Working Group agreed to include reference to proportional liability and to consider adding reference to foregoing limited liability protection entirely (para. 36, A/CN.9/895).

<sup>115</sup> Similar approaches may be found in various legislative enactments in respect of fiduciary duties. For example, the United States Revised Uniform Limited Liability Company Act of 2006 clarifies the ability of members to define and limit the duties of loyalty and care that members owe to each other and to the business entity. See, also, the Delaware General Corporation Law, Section 102(b) (7), which allows the members to limit the duty of care by agreeing to eliminate or limit the personal liability of a manager to the business entity or its members in such cases.

<sup>116</sup> The Secretariat has adjusted the commentary of this section (paras. 12 to 16 of A/CN.9/WG.I/WP.99/Add.1) for improved clarity.

<sup>117</sup> At its twenty-eighth session, the Working Group agreed to include in the commentary a paragraph on the enforcement of fiduciary duties that should include how legal claims can be brought individually and collectively against managers in breach, and including alternative dispute resolution (para. 149, A/CN.9/900).

<sup>118</sup> The Working Group may wish to decide whether reference to the duty to disclose information is necessary in the text of the recommendation, and if so, to determine the extent of the discussion it receives, including whether to describe types of information that must be disclosed, the timeline for disclosure, and any exceptions to the requirements.

<sup>119</sup> At its twenty-eight session, the Working Group agreed that the approach should be changed from an "opt in" fiduciary duty to one owed to all other members unless otherwise agreed (para. 147, A/CN.9/900). The Secretariat has therefore made adjustments to the commentary and to the recommendation. The Working Group may also wish to consider whether the recommendation should provide for a legal cause of action, particularly with regard to derivative suits.

<sup>120</sup> The Secretariat has redrafted rec. 16 (rec. 13 in A/CN.9/WG.I/WP.112) to include the fiduciary duties that UNLLO managers owe to the UNLLO and its members, as agreed by the Working Group at its twenty-eighth session (para. 151, A/CN.9/900).

*guide to provide guidance for members on valuating contributions not made in cash.]*

## E. Members' share of and contributions to the UNLLO<sup>121</sup>

78. The UNLLO is not required to have legal capital upon registration, so it is not necessary for members to make contributions to it in order for it to exist.<sup>122</sup> Members may choose to require contributions in their members' agreement and to establish what each member will provide to the UNLLO by way of contribution. In this respect, the law should permit members maximum flexibility to decide upon the amount, type and timing of their agreed contributions to the UNLLO, including the flexibility to determine that members are not required to make contributions in order to be members of the UNLLO.<sup>123</sup>

79. In specifying in the members' agreement the types of contributions that members of the UNLLO may make, members may wish to consider tangible and intangible property as well as other benefits to the UNLLO, including money, services performed, promissory notes, other binding agreements to contribute money or property and contracts for services to be performed. Although maximum flexibility with respect to contributions to the UNLLO is encouraged, in some cases, other laws of the enacting State may restrict the types of contribution that may be made. For example, in some States, the provision of services is not permitted as a contribution to the establishment of a business entity. In such cases, those restrictions should be specified in the law prepared on the basis of this legislative guide.<sup>124</sup>

80. The determination of the value of each contribution should be left to the members of the UNLLO, as they are in the best position to determine that value. Should members wish to include duties to each other in terms of the accurate value of their contribution, this may be accomplished in the members' agreement. Any other mechanism, such as requiring an audit or other external valuation method, is likely to be too burdensome for MSMEs. It is recommended that the UNLLO maintains a record (see also recs. 25 and 26 below) of the amount, type and timing of contribution of each member to ensure that the rights of the members are respected.

81. When members have identified the respective values of their contributions in the members' agreement, recommendation 17 provides a default rule that each member's share of the UNLLO will be determined in accordance with those respective values.<sup>125</sup>

82. In instances where members agree to make contributions to the UNLLO, but do not agree upon the value<sup>126</sup> of the contributions, recommendation 17 provides that the value of contributions by each member should be deemed equal.

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<sup>121</sup> The Secretariat has modified the title of this section for consistency with the revised commentary and rec. 17.

<sup>122</sup> The Secretariat has deleted the final sentence ("The UNLLO...its operations") of para. 78, (para. 87 of A/CN.9/WG.I/WP.112) as agreed by the Working Group at its thirty-first session (para. 79, A/CN.9/963).

<sup>123</sup> The Secretariat has added the sentences "Members may...of the UNLLO" to the paragraph to emphasize that making contributions to the UNLLO may not be necessary in order to become a member (para. 79, A/CN.9/963).

<sup>124</sup> The Secretariat has relocated para. 79 (para. 89 of A/CN.9/WG.I/WP.112) further to a decision of the Working Group at its thirty-first session as this would better illustrate the subject of non-monetary contributions (para. 80, A/CN.9/963).

<sup>125</sup> The Secretariat has included a sentence to state that a member's share in the UNLLO should correspond to its percentage of contribution to the UNLLO, as agreed by the Working Group at its thirty-first session (para. 81, A/CN.9/963).

<sup>126</sup> At its thirty-first session the Working Group agreed to replace "amount" with "valuation" in para. 82 (para. 88 of A/CN.9/WG.I/WP.112), since the term "valuation" did not give the impression that contributions to the UNLLO should be in cash (para. 80, A/CN.9/963). The Secretariat actually suggests replacing "valuation" with "value".

83. Consequently, recommendation 17 provides a default rule in such instances to state that a member's share in the UNLLO should also be deemed equal. However, given the "freedom of contract" principle that governs the legislative guide, it should be permissible for members to decide their share in the UNLLO among themselves in the members' agreement. They should also be permitted to agree on more complex ownership structures in their members' agreement.<sup>127</sup>

**Recommendation 17: The law should provide that:**

- (a) **Members of the UNLLO are permitted to agree upon contributions, if any, they make to the UNLLO, including their type, timing and value. In the absence of such agreement, contributions made to the UNLLO are deemed equal for all members;**
- (b) **Unless otherwise agreed in the members' agreement, the members' share of the UNLLO shall be in accordance with the agreed value of their contributions; and**
- (c) **When members have not agreed upon a value of their contributions, any contributions shall be deemed equal, and members will have an equal share of the UNLLO unless they agreed otherwise in the members' agreement.**<sup>128</sup>

## F. Distributions

84. In keeping with the general default approach of the UNLLO, the legislative guide provides not only that members will have an equal share of the UNLLO but also to any distributions made by it, unless they have otherwise agreed in their members' agreement.

85. The members of the UNLLO may also agree on the type of distribution (for example, including cash or property of the UNLLO) as well as the timing of such distributions. It is advisable for States that do not permit non-monetary distributions to specify those restrictions in the UNLLO law.

**Recommendation 18: The law should provide that distributions are made to members in proportion to their respective share of the UNLLO as stated in the members' agreement. When the member's share of the UNLLO is not so stated, distributions by the UNLLO shall be made equally among its members.**

86. Although the amount, type and timing of distributions may be subject to the members' decision,<sup>129</sup> the legislative guide includes mandatory provisions governing distributions aimed at protecting third parties dealing with the UNLLO. Accordingly, the members of the UNLLO cannot contract out of the rule prohibiting distributions which would violate either the cessation of payment test<sup>130</sup> set out in recommendation 19(a), or the balance sheet test set out in recommendation 19(b). Under the cessation of payment test, the UNLLO must still be able to pay its debts following the distribution, while the balance sheet test ensures that distributions can only be made if the UNLLO's remaining assets exceed its total liabilities.

<sup>127</sup> The Working Group agreed at its thirty-first session that given the scope of rec. 17 (rec. 16 in A/CN.9/WG.I/WP.112) reference to "classes and types of membership" was considered to be unnecessary complicated. The Secretariat has thus deleted the phrase "including...of membership" (para. 78, A/CN.9/963).

<sup>128</sup> At its thirty-first session, the Working Group agreed to revise recs. 16 and 17 in A/CN.9/WG.I/WP.112 and combine them into one recommendation. The Secretariat has implemented that change accordingly with some editorial adjustments (para. 88, A/CN.9/963).

<sup>129</sup> Given the approach taken in rec. 17, the Secretariat recommends identifying when decisions require majority by number or majority by share.

<sup>130</sup> The Secretariat has replaced the term "insolvency test" with "cessation of payment test" for consistency with the UNCITRAL Legislative Guide on Insolvency Law (see Part two, Chapter I, Section B of that Guide).

87. This mandatory rule, in conjunction with the clawback provision in recommendation 20, is intended to protect third parties and creditors who are dealing with the UNLLO from any dissipation of the UNLLO's assets through improper distributions to its members.

88. In most cases, the UNLLO will be managed by all of its members exclusively, and so holding each member liable to return the amount of the improper distribution as indicated in recommendation 20 should act as an adequate disincentive against such distributions.<sup>131</sup> Where the UNLLO is managed by one or more designated manager(s), the duties set out in recommendation 16(a), with recommendations 19 and 20, should provide an adequate basis on which to find managers liable for any improper distributions they make.

**Recommendation 19: The law should prohibit distributions from being made to any member if upon giving effect to such distribution:**

- (a) **The UNLLO would not be able to pay its debts as they become due in the ordinary course of business; or**
- (b) **The UNLLO's total assets would be less than the sum of its total liabilities.**

89. In keeping with the rule on improper distributions established in recommendation 19, recommendation 20 is an operative provision that permits the amount of any such distribution to be clawed back from each member who received that distribution, or any improper portion of a distribution. Such a rule is intended both to protect third parties dealing with the UNLLO and to disincentivize members from accepting improper distributions, which may leave the UNLLO insolvent.<sup>132</sup>

90. It should be noted that payments of reasonable compensation for services rendered and for bona fide debts owed by the UNLLO to a member should not be considered distributions, and would thus not be subject to the clawback provision in recommendation 20.

91. In addition, as noted in paragraph 88 above, managers that make distributions in violation of one of the tests in recommendation 19 could also be held liable to the UNLLO.

**Recommendation 20: The law should provide that each member who received a distribution, or any portion thereof, made in violation of recommendation 19 is liable to reimburse the UNLLO for this distribution or portion thereof.<sup>133</sup>**

## G. Transfer of rights

92. Because the UNLLO legal form will mainly be used by MSMEs, its members are likely to attach great importance to the composition of its membership, as is often the case in small businesses (see para. 59 above), and to resist transfers of a member's share of the UNLLO without the approval of other members. In addition, there might not be a ready market for the transfer of a share of an UNLLO.

93. The member's share of an UNLLO entitles it to exercise two sets of rights: financial rights to partake in the profits and losses of the UNLLO and to receive

<sup>131</sup> For consistency, the Secretariat has removed the reference to a lack of a specific provision holding managers liable for making improper distributions (para. 32 of A/CN.9/WG.I/WP.99/Add.1).

<sup>132</sup> The Secretariat has deleted "or with greater liabilities than assets" to avoid redundancy with the term "insolvent". See definition of insolvency in the UNCITRAL Legislative Guide on Insolvency Law.

<sup>133</sup> The Secretariat has modified the text and commentary of recs. 19 and 20 (recs. 20 and 21 in A/CN.9/WG.I/WP.99/Add.1) to clarify that a member is not liable for the entire distribution if only a portion was received and is not liable for the entire distribution when only a portion was made in violation of rec. 19.

distributions, and decision-making rights to participate in the management and control of the UNLLO.<sup>134</sup> The default rule established for most aspects of the UNLLO in the legislative guide is that members have equal rights.

94. Consistent with this general approach, the default rule set out in the guide permits members of the UNLLO to transfer their financial rights, unless they have agreed otherwise in their members' agreement. In addition, bearing in mind the general nature of UNLLOs, the default rule in respect of the transfer of rights to take decisions on the UNLLO is that these rights are not transferable by members, unless they have agreed otherwise in their members' agreement. This latter rule reflects the idea that, given the particular characteristics of the UNLLO, members not seeking to transfer their rights must consent to changes in the management and control of the UNLLO. These rules are reflected in recommendation 21.

95. In the situation of the death of a single member of the UNLLO, complications could arise in that the member's financial rights might be transferable, but not the member's governance rights. The members' agreement should contain appropriate provisions to provide any necessary clarity in that circumstance.<sup>135</sup>

**Recommendation 21: The law should provide that members may transfer their financial rights in the UNLLO, but not their decision-making rights, unless otherwise agreed in the members' agreement.<sup>136</sup>**

*[Note to the Working Group: The Working Group may wish to consider whether recommendations 22 to 24 should be made mandatory, and the Working Group may then wish to include provisions for parties to deviate from them by members' agreement, noting that throughout the legislative guide, reference has been made to these being matters outside of the ordinary course of business.]*

*Additionally, the Working Group may wish to consider specific provisions on expulsion of a member in the discussion of dissociation or withdrawal.*

*Finally, the Working Group may as well wish to consider whether it would be advisable to have a separate discussion on dissolution and winding-up for a single-member UNLLO and more sophisticated forms of an UNLLO (para. 90, A/CN.9/963).]*

## H. Restructuring or conversion

96. As noted above (para. 44) in respect of recommendation 7, the legislative guide is intended to permit the UNLLO to evolve from a very small enterprise to a more complex multi-member entity, and possibly to convert into another legal business form altogether. That approach is reflected in recommendation 22, which permits the members of the UNLLO to agree to restructure the UNLLO or to convert it into a different legal form.

97. Further, as noted above in paragraph 64 in connection with recommendation 12, a decision on the restructuring or conversion of the UNLLO would be a decision outside of the ordinary course of business, and would thus require a decision by [qualified majority], unless otherwise indicated in the members' agreement.

<sup>134</sup> The Secretariat has eliminated the phrase "including fiduciary rights and information rights" from para. 93 (para. 100 of A/CN.9/WG.I/WP.112) until the Working Group has considered a definition for the classification of decision and financial rights.

<sup>135</sup> The Working Group may wish to consider providing a default rule in the legislative guide for such instances. See also, *supra*, footnotes 59 and 64.

<sup>136</sup> For greater clarity of the recommendation (rec. 22 in A/CN.9/WG.I/WP.99/Add.1), the Secretariat has: (a) replaced "non-financial rights" with "decision-making rights"; (b) deleted the phrase "in the UNLLO" after "decision-making rights"; and (c) replaced the phrase "Members...by agreement" (as it appeared in rec. 22 in A/CN.9/WG.I/WP.99/Add.1) with "unless...agreement".

98. The State in which the UNLLO would restructure or convert to another legal form may wish to ensure that adequate safeguards are in place to protect third parties dealing with the UNLLO from any adverse effects on their rights that could arise from such a restructuring or conversion of the UNLLO. Such safeguards may already exist in legislation providing for conversion into other legal business forms, and could consist, for example, of notice periods, publication requirements or rules on the transfer of third party rights to the new legal form.<sup>137</sup>

**Recommendation 22: The law should provide that the members of an UNLLO may agree to restructure it or convert it into another legal form by [qualified majority].<sup>138</sup>**

## I. Dissolution and winding-up

99. Recommendation 23, subparagraph (a), establishes that the members of the UNLLO may decide in their members' agreement that the UNLLO will be dissolved and wound up on the occurrence of an event specified in that agreement. Should the members of the UNLLO not have established terms under which the UNLLO would be dissolved and wound up, they may decide by [qualified majority] to dissolve and wind up the entity as indicated in subparagraph (b) of recommendation 23. This level of required consent is commensurate with that required in respect of a decision by members on restructuring the UNLLO or converting it into another legal form, as well as reflecting the default rule for decisions made by members on matters outside of the ordinary course of business.

100. Recommendation 23, subparagraph (c), is a mandatory rule that members may not vary by agreement. A judicial or administrative decision made pursuant to the law of the State that the UNLLO is dissolved must be respected by the members of the UNLLO, and could include, for example, a decision by an insolvency court.

101. Again, the State in which the UNLLO would be dissolved or wound up may wish to ensure that adequate safeguards are in place to protect third parties from any adverse effects that could arise from the UNLLO's dissolution or winding-up. Such safeguards may already exist in other legislation providing for dissolution or winding-up of legal business forms.

**Recommendation 23: The law should provide that the UNLLO shall be dissolved and wound up in the following circumstances:**

- (a) On the occurrence of any event that is specified in the members' agreement as causing the dissolution of the UNLLO;
- (b) On a decision by [qualified majority] of the members; or
- (c) Upon the rendering of a judicial or administrative decision that the UNLLO is dissolved.

## J. Dissociation or withdrawal

102. As noted above (see para. 63), an UNLLO will be often managed by all of its members exclusively. Indeed, the default rule throughout this legislative guide is that members of an UNLLO will have equal financial and decision-making rights unless otherwise agreed by the members themselves.<sup>139</sup> This is further reflected in the fact that in an UNLLO managed by all of its members exclusively, the default rule requires

<sup>137</sup> The Secretariat has replaced "business" with "legal" both in para. 98 (para. 105 of A/CN.9/WG.I/WP.112) and in rec. 22 for improved clarity of the text.

<sup>138</sup> The Secretariat has added the phrase "agree to" and changed "agreement" to "majority."

<sup>139</sup> The Secretariat has modified the initial sentence of this paragraph (para. 109 of A/CN.9/WG.I/WP.112).

decisions made outside of the ordinary course of business to be made by a [qualified majority] of the members (rec. 12(c)).<sup>140</sup> Such extraordinary matters would include issues relating to the very existence of the UNLLO, such as its restructuring, conversion to a different legal business form, or dissolution and winding-up (see para. 64 above). Similarly, the default rule for resolving differences among members on matters in the ordinary course of business of the UNLLO is that they may be decided by a majority of members (rec. 12(b)), thus providing a convenient way to resolve more routine differences of view among the UNLLO members. These two default rules provide a reasonable and coherent decision-making system for members to resolve basic disputes and to continue to conduct the affairs of the UNLLO, whilst at the same time allowing<sup>141</sup> for members to dissent. Depending on that member's share of the UNLLO, the rules may effectively provide the member with a veto.

103. However, members of the UNLLO may not find these default decision-making mechanisms adequate once dissatisfaction or distrust disrupts their relationship. Members may not have foreseen the possibility of intractable disputes and they may be unable to settle them internally. As such, the UNLLO legislation should include a default rule for dealing with such disputes.

104. One approach to developing a default rule could be to permit one or more dissatisfied members to compel the dissolution of the UNLLO and the liquidation of its assets. This approach, however, could create uncertainty and instability for the members and the UNLLO. Most importantly, perhaps, it would not permit continuation of the UNLLO and would thus result in a net loss in economic value.

105. A second approach to dealing with intractable member disputes would be to facilitate the continued existence of the UNLLO, but permit members to withdraw or to be expelled from the UNLLO and to receive the fair value of their share of the UNLLO.<sup>142</sup> However, permitting such an arrangement could be subject to abuse and result in minority oppression. In the scenario in which a conflict among members could result in a majority of members expelling a minority, the minority would be left to keep its share or to sell it back to the majority members for whatever price the majority was willing to offer.

106. Recommendation 24 suggests that the preferred approach in creating a default rule to resolve intractable disputes is to permit members to withdraw from the UNLLO and to be paid the fair value of their interest over a reasonable time. This would allow the UNLLO to continue existing unless the members decide otherwise by [qualified majority], thus preserving both the UNLLO's economic stability and value. Moreover, permitting the payment of the fair value of a withdrawing member's share of the UNLLO over time would avoid a situation where the withdrawing member held the UNLLO and its remaining members to ransom by demanding immediate payment of the entire amount. Complying with a demand of that sort might not be possible for the UNLLO or its remaining members, and might effectively force its dissolution if it is rendered insolvent.

107. The default rule suggested in recommendation 24 may still present challenges in terms of assessing the fair value of the withdrawing member's share of the UNLLO. The starting point for that valuation should be that the withdrawing members would receive the same amount in a buyout as that member would receive if the UNLLO were dissolved. However, fair value dictates that the value of the UNLLO's goodwill should also be included in the calculation, and the buyout price for the members

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<sup>140</sup> See however *supra*, footnote 98.

<sup>141</sup> Given the Working Group's decision to replace unanimity with qualified majority at its twenty-seventh session (para. 63, [A/CN.9/895](#)), there would no longer be an effective veto. The Secretariat has therefore amended this paragraph accordingly. The Secretariat has retained the final sentence of para. 102, noting that it would need to be amended if the Working Group came to the agreement that decision-making rights should not be apportioned by share.

<sup>142</sup> The Working Group may wish to consider whether to include provisions on expulsion in the legislative guide.

withdrawing should thus be the greater of that member's part of the liquidation value of the UNLLO or a value based on the sale of the entire UNLLO as a going concern.

108. It would also be prudent for members to decide in their members' agreement to use alternative dispute resolution mechanisms (see rec. 27) for matters that cannot be resolved through the application of the members' agreement or the default rules. Determining the fair valuation of a withdrawing member's share could be one of the issues that might be resolved through alternative dispute resolution.<sup>143</sup>

**Recommendation 24: The law should provide that, unless otherwise agreed, members may withdraw from the UNLLO and be paid over a reasonable period of time the fair value of their share<sup>144</sup> of the UNLLO.<sup>145</sup>**

## K. Record-keeping, inspection and disclosure

109. Open communication and transparency are important issues for any business entity, but they are arguably of even greater importance in respect of the UNLLO. Members of the UNLLO are likely to have an equal share of the UNLLO, and establishing and maintaining trust among them is of great importance. Access to and proper dissemination of information to all members will further enhance trust among members and will permit them to be meaningfully involved in decision-making processes, thus providing a strong basis for the positive performance of the UNLLO.

110. The importance of sharing and disseminating information on the UNLLO among its members is emphasized by the mandatory rules set out in recommendations 25 and 26. Recommendation 25 requires the UNLLO to keep certain information and recommendation 26 ensures that each member has the right to inspect this information, as well as the right to access any other information regarding the UNLLO that would be reasonable for the UNLLO to keep, which may include information on its activities, operations and financial situation. Members can agree that the UNLLO should retain information additional to that required in recommendation 25.<sup>146</sup>

111. While the focus of the UNLLO is MSMEs and facilitation of their growth, disclosure and transparency of information are naturally important issues facing any business entity. While some States apply broad disclosure requirements to privately held entities (but allow exceptions to be made for MSMEs), others limit mandatory disclosure to public business entities.<sup>147</sup> In keeping with the intended simplicity of the UNLLO, the legislative guide recommends that the information to be retained by the UNLLO further to recommendation 25 need not be publicly disclosed, although it should be shared with all members and subject to their inspection.

112. The list of records that must be kept pursuant to recommendation 25 should not be particularly burdensome for UNLLOs, even when they are micro and small businesses, in that it consists of basic information necessary for entrepreneurs of all levels of sophistication to run their business. Moreover, the records that must be kept need only be "reasonable records", i.e. recorded in a timely fashion and in a medium that could be expected of a similar business operating in a comparable context. The

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<sup>143</sup> See the section on "Conflict resolution", infra.

<sup>144</sup> In keeping with decisions of the Working Group at its thirty-first session that the terms "share" should be used to indicate the members' financial and decision-making rights in the UNLLO, the Secretariat has replaced "interest" with "share" (para. 77 of A/CN.9/963).

<sup>145</sup> The Working Group may wish to consider whether it should be clarified that rec. 24 does not require an UNLLO to pay upon any request of a member to withdraw, but should require reasonable cause or an agreement among members. The Secretariat suggests modifying the recommendation to something along the lines of: "The law should provide that, upon agreement or reasonable cause, members may withdraw from the UNLLO and be paid over a reasonable period of time the fair value of their share in the UNLLO unless otherwise agreed."

<sup>146</sup> The Secretariat has revised para. 110 (para. 117 of A/CN.9/WG.I/WP.112) for further clarity of the text.

<sup>147</sup> The Secretariat has deleted the phrase "Subject to...made public", after "public business entities" for improved consistency of the paragraph.

recommendation does not specify when or how that information must be kept, and it would be open to the UNLLO to simply rely on electronic or other records that are reasonable for a business of its size and complexity.

113. For example, many MSMEs use various mobile applications that are available on electronic devices to run their commercial enterprises, and they are thus easily able to track and access all types of information relevant to the business, including inventory, simple balance sheets, and even tax returns. An UNLLO operating in that context could then satisfy the requirements of recommendations 25 and 26 by retaining and permitting access to the information electronically available via that mobile application.

**Recommendation 25: The law should provide that the UNLLO must keep reasonable records including:**

- (a) **Its formation data;**<sup>148</sup>
- (b) **Any record of the members' agreement;**
- (c) **A current list of managers and members, as well as their contact details;**
- (d) **Financial statements (if any);**
- (e) **Tax returns or reports; and**
- (f) **The activities and operations of the UNLLO.**<sup>149</sup>

**Recommendation 26: The law should provide that each member has the right to:**

- (a) **Inspect and copy any of the records required to be kept by the UNLLO under recommendation 25; and**
- (b) **Obtain from the UNLLO information concerning its activities, operations and finances, as well as any other information that would be reasonable for the UNLLO to keep.**<sup>150</sup>

## L. Conflict resolution<sup>151</sup>

114. Members can usually negotiate among themselves to arrive at an efficient resolution of disputes concerning the operation of the UNLLO. As noted in paragraphs 105 and 108 above, however, they may not be able to settle a dispute once dissatisfaction or distrust disrupts their relationship and resolution may thus require that they engage in potentially long and expensive litigation. Further, paragraphs 72 to 77 above describe fiduciary duties and the role they play in providing important safety mechanisms to protect members against opportunistic actions of a manager or another member. From the perspective of some legal traditions, however, open-ended fiduciary duties may not be easily enforceable unless they are clearly enunciated as formal legal rules. In both instances, alternative dispute resolution (“ADR”) mechanisms, such as arbitration, mediation and other extrajudicial methods can assist members of an UNLLO in reaching an outcome consistent with the simple nature of the UNLLO, where interpersonal relationships play an important role in the management of the business.

<sup>148</sup> The Secretariat has replaced “formation document” with “formation data” for the reasons in the Note preceding para. 19.

<sup>149</sup> The Secretariat has deleted the phrase “financial information” from rec. 25 (f) to avoid redundancy with rec. 25(d).

<sup>150</sup> For improved clarity of the text, the Secretariat has: (a) replaced “financial information” with “finances”; (b) split rec. 26 in two parts; and (c) replaced “reasonable information” with “information that...keep”.

<sup>151</sup> The Secretariat has revised paras. 114 to 116 (paras. 121 to 123 of A/CN.9/WG.I/WP.112) for improved clarity of the text.

115. ADR mechanisms would also benefit the UNLLO in commercial disputes with third parties dealing with the UNLLO, such as creditors, suppliers or clients, where court processes could also be too lengthy and expensive. UNLLOs involved in legal disputes with those third parties would need to weigh the cost of court processes against the costs of unresolved disputes, which may include unpaid accounts when deciding how to pursue their disputes. Members of the UNLLO may also face geographic, linguistic and cultural barriers within a court system (for example, women may face formal or practical restrictions in accessing the courts or the UNLLO members might not be fluent in the official language of the courts). ADR mechanisms will help reduce these obstacles. Not only are they typically faster, but these mechanisms may also be cheaper and permit a more informal and participatory approach to dispute resolution, as well as facilitate parties in working toward a more collaborative outcome than what may be possible through the judicial settlement of the dispute.

116. While recourse to an ADR mechanism would provide a valuable tool for UNLLOs in legal disputes, there may be restrictions within the State's domestic legal framework on the types of cases which may be subject to ADR, including restrictions on the availability of ADR for criminal matters, labour and competition matters, or insolvency. Such matters would be beyond the scope of the legislative guide and are therefore excluded from the recommendation.

**Recommendation 27: The law should provide that any dispute that arises among members of the UNLLO or any third party may be submitted to alternative dispute resolution mechanisms, unless there are restrictions upon such actions within the State's domestic legal framework.<sup>152</sup>**

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<sup>152</sup> At its twenty-eighth session, the Working Group agreed to include a new recommendation in the legislative guide encouraging the use of alternative dispute settlement in respect of the UNLLO (para. 149, [A/CN.9/900](#)). See also *supra* footnote 143 and para. 108.

## Appendix

### Recommendations on an UNLLO

#### A. General provisions

**Recommendation 1:** The law should provide that an UNCITRAL Limited Liability Organisation (“UNLLO”) is governed by [this law] and by the members’ agreement.

**Recommendation 2:** The law should provide that an UNLLO may be organized for any lawful business or commercial activity.

**Recommendation 3:** The law should provide that the UNLLO has a legal personality distinct from its members.

**Recommendation 4:** The law should provide that a member is not personally liable for the obligations of the UNLLO solely by reason of being a member of that UNLLO.

**Recommendation 5:** The law should not require a minimum capital for the formation of an UNLLO.

**Recommendation 6:** The law should provide that the name of the UNLLO must include a phrase or abbreviation that identifies it as an UNLLO.

#### B. Formation of the UNLLO

**Recommendation 7:** The law should:

(a) Provide that an UNLLO must have at least one member from the time of its formation [until its dissolution]; and

(b) Specify whether only natural persons or also legal persons are permitted to be members of an UNLLO.

**Recommendation 8:** The law should provide that the UNLLO is formed once it is registered.

**Recommendation 9:** The law should keep the information required for the formation of the UNLLO to a minimum. Such information should include:

(a) The name of the UNLLO;

(b) The business address or, when the business does not have a standard form address, precise geographical location of the UNLLO; and

(c) The identity of each person who manages the UNLLO.

#### C. Organization of the UNLLO

**Recommendation 10:** The law should provide that the members of the UNLLO may adopt a members’ agreement in any form, including an agreement that is written, oral or implied by course of conduct. That agreement may address any matter relating to the UNLLO, except issues covered by the mandatory rules set out in recommendations 1, 2, 3, 4, 6, 7, 8, 9, 16(a), [15], 19, 20, 23(c), 25 and 26.

#### D. Management of the UNLLO

**Recommendation 11:** The law should provide that:

(a) The UNLLO is managed by all of its members exclusively unless otherwise indicated in the [members’ agreement/formation document]; and

(b) Members of the UNLLO may agree in their [members' agreement/formation document] to appoint one or more designated managers.

**Recommendation 12:** The law should provide that when the UNLLO is managed by all of its members exclusively and unless otherwise stipulated in the member's agreement:

(a) The members of the UNLLO have joint and equal rights to decide on matters concerning the activities and affairs of the UNLLO;

(b) Differences among members on matters concerning the ordinary course of activities and affairs of the UNLLO should be resolved by a [majority] decision of the members; and

(c) Differences among members on matters outside the ordinary course of business should be resolved by [qualified majority].

**Recommendation 13:** The law should provide that, unless otherwise agreed in the members' agreement, one or more designated manager(s) may be appointed and removed by a majority decision of the members.

**Recommendation 14:** The law should provide that when the UNLLO is managed by one or more designated manager(s):

(a) Managers are responsible for all matters that are not retained by the members of the UNLLO pursuant to [this law] or the members' agreement; and

(b) Differences among managers should be resolved by a [majority] decision of the managers, unless otherwise stipulated in the members' agreement.

**Recommendation 15:** The law should provide that each manager individually has the authority to bind the UNLLO unless otherwise agreed. Restrictions upon that authority will not be effective against third parties dealing with the UNLLO without proper notice.

**Recommendation 16:** The law should provide that:

(a) A manager of the UNLLO owes: (i) a duty of care; (ii) a duty of loyalty; (iii) a duty to disclose information to all members of the UNLLO; and (iv) a duty of good faith and fair dealing; and

(b) Unless otherwise stated in the member's agreement, fiduciary duties also apply to members of the UNLLO.

## E. Members' share of and contributions to the UNLLO

**Recommendation 17:** The law should provide that:

(a) Members of the UNLLO are permitted to agree upon contributions, if any, they make to the UNLLO, including their type, timing and value. In the absence of such agreement, contributions made to the UNLLO are deemed equal for all members;

(b) Unless otherwise agreed in the members' agreement, the members' share of the UNLLO shall be in accordance with the agreed value of their contributions; and

(c) When members have not agreed upon a value of their contributions, any contributions shall be deemed equal, and members will have an equal share of the UNLLO unless they agreed otherwise in the members' agreement.

## F. Distributions

**Recommendation 18:** The law should provide that distributions are made to members in proportion to their respective share of the UNLLO as stated in the

**members' agreement. When the member's share of the UNLLO is not so stated, distributions by the UNLLO shall be made equally among its members.**

**Recommendation 19:** The law should prohibit distributions from being made to any member if upon giving effect to such distribution:

- (a) The UNLLO would not be able to pay its debts as they become due in the ordinary course of business; or
- (b) The UNLLO's total assets would be less than the sum of its total liabilities.

**Recommendation 20:** The law should provide that each member who received a distribution, or any portion thereof, made in violation of recommendation 19 is liable to reimburse the UNLLO for this distribution or portion thereof.

## **G. Transfer of rights**

**Recommendation 21:** The law should provide that members may transfer their financial rights in the UNLLO, but not their decision rights, unless otherwise agreed in the members' agreement.

## **H. Restructuring or conversion**

**Recommendation 22:** The law should provide that the members of an UNLLO may agree to restructure it or convert it into another legal form by [qualified majority].

## **I. Dissolution and winding-up**

**Recommendation 23:** The law should provide that the UNLLO shall be dissolved and wound up in the following circumstances:

- (a) On the occurrence of any event that is specified in the members' agreement as causing the dissolution of the UNLLO;
- (b) On a decision by [qualified majority] of the members; or
- (c) Upon the rendering of a judicial or administrative decision that the UNLLO is dissolved.

## **J. Dissociation or withdrawal**

**Recommendation 24:** The law should provide that, unless otherwise agreed, members may withdraw from the UNLLO and be paid over a reasonable period of time the fair value of their share of the UNLLO.

## **K. Record-keeping, inspection and disclosure**

**Recommendation 25:** The law should provide that the UNLLO must keep reasonable records including:

- (a) Its formation data;
- (b) Any record of the [members' agreement];
- (c) A current list of managers and members, as well as their contact details;
- (d) Financial statements (if any);
- (e) Tax returns or reports; and

(f) The activities and operations of the UNLLO.

**Recommendation 26:** The law should provide that each member has the right to:

- (a) Inspect and copy any of the records required to be kept by the UNLLO under recommendation 25; and
- (b) Obtain from the UNLLO information concerning its activities, operations and finances, as well as any other information that would be reasonable for the UNLLO to keep.

**L. Conflict resolution**

**Recommendation 27:** The law should provide that any dispute that arises among members of the UNLLO or any third party may be submitted to alternative dispute resolution mechanisms, unless there are restrictions upon such actions within the State's domestic legal framework.