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Draft Legislative Guide on an UNCITRAL Limited Liability Organisation

Note by the Secretariat

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II. Draft legislative guide on an UNCITRAL Limited Liability Organisation (UNLLO) (*continued*)

C. Organization of the UNLLO

1. As noted above (in A/CN.9/WG.I/WP.99) in respect of draft recommendation 1,¹ the Working Group has agreed in principle that freedom of contract should be the guiding principle in establishing the internal organization of the UNLLO.² 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 by member agreement. The agreement between the members of the UNLLO is referred to in this text as the “members’ agreement.”³ Where an UNLLO has only one member, the member’s agreement will reflect the will of the single member, and may also be oral, in writing or by conduct. When the members’ agreement is silent on a non-mandatory issue, resort is had to the default rules in this draft legislative guide in order to fill any rule-making gap.

2. The members’ agreement refers to the written or oral agreement among the members of the UNLLO, or an agreement that is established through a course of conduct, that governs the affairs of the UNLLO and the relationships of its members with each other. The broad flexibility permitted for the form of the members’ agreement recognises that in the case of many MSMEs, there may be no formal written agreement at all, and that, in such cases, members should be able to rely on oral agreements and agreement by conduct.⁴ It should be cautioned, however, that it may be in the best interests of members to have a written agreement, since oral members’ agreements or agreements by conduct are more difficult to prove should there be a dispute.

3. This draft legislative guide does not require that an UNLLO members’ agreement be made public, but instead requires sufficient information about the UNLLO to be disclosed in the formation information in order to provide adequate protection to third parties. In addition, this approach protects the privacy of members (unless they are also managers, in which case only their names will be made public) 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.⁵

¹ See, *supra*, paras. 27-28, A/CN.9/WG.I/WP.99.

² Again, as noted above (see, *supra*, note 24, A/CN.9/WG.I/WP.99), the Working Group also observed that standard forms could be useful to assist MSMEs that might find it difficult to establish rules by agreement (see para. 63, A/CN.9/800 and para. 23 of A/CN.9/WG.I/WP.86). Once the Working Group has advanced its work on this draft legislative guide, it may wish to consider whether it would be useful to prepare standard form members’ agreements to assist MSMEs in this regard.

³ The term “members’ agreement” has replaced the previous term “operating document” (see paras. 39 and 68, A/CN.9/831) used in the draft texts that the Working Group has considered to date (A/CN.9/WG.I/WP.86/Add.1 and A/CN.9/WG.I/WP.89).

⁴ The Working Group has made reference to the likelihood of such oral agreements in the past (see para. 52, A/CN.9/831).

⁵ See also para. 12, A/CN.9/WG.I/WP.89.

4. The list of mandatory recommendations that cannot be contracted out of by members in their agreement is included in this draft recommendation. The rules that are mandatory are those that establish the necessary legal framework of the UNLLO and provide legal certainty, or that are necessary to protect the rights of the UNLLO and of third parties dealing with the UNLLO.

Recommendation 11: 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 established by way of conduct. The members may agree in their members' agreement on any matter relating to the UNLLO, except in respect of the mandatory rules set out in recommendations 1, 2, 3, 6, 7, 8, 9, 14, 15, 20, 21, 24(c), 26 and 27.

5. The organization of the UNLLO is based on simple default rules that offer a clear solution for the problems that may occur in multi-member privately held companies in which the composition of the entity's membership is likely to be an important characteristic. This is due to the fact that an UNLLO will likely have a relatively small number of members who will have substantial participation in the management and operation of the UNLLO.

6. A professional manager approach (which is common, of course, in public companies) may be poorly tailored to fit the governance needs of many privately held firms, particularly when they are micro and small enterprises, and, as noted above, where members most often take on management roles as well. Draft recommendation 12 thus makes a member-managed UNLLO (i.e. decentralized management) the default approach. Since draft recommendation 13(a) sets out the default rule that the members of an UNLLO have equal rights to manage it, the default rule in draft recommendation 12 that the UNLLO is member-managed means that it is managed by all members.

7. Draft recommendation 12 also permits the members to agree that the UNLLO will be manager-managed (i.e. centralised management), in which case one or more managers will be elected by the members in accordance with the members' agreement (see draft recommendation 16), and those managers will take on the management of the regular operations of the UNLLO.

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

Recommendation 12: The law should provide that the UNLLO is member-managed by all members, unless otherwise agreed.

9. When the UNLLO is member-managed, its member-managers will have joint and equal management and control rights, unless they agree otherwise in the members' agreement. This is also reflected in draft recommendation 15 below, which grants each publicly disclosed manager the authority to bind the UNLLO in its dealings with third parties.⁶

10. Further, unless there is agreement to the contrary, matters that arise in the ordinary course of business of the UNLLO will be decided by a simple majority of

⁶ Permitting members to vary their equal management rights will not adversely affect third parties, since the UNLLO will be bound by any decision by a publicly disclosed manager (see draft recommendations 9 and 15).

its members, and decisions that are outside of the ordinary course of business of the UNLLO would require the unanimous approval of its members. Decisions outside of the ordinary course of business would include decisions such as those relating to dissolution and winding-up of the UNLLO, to its conversion to another business form, or to changing its organization from a member-managed to a manager-managed model, or vice versa.⁷ This default approach to member-management of the UNLLO is reflected in draft recommendation 13.

11. This draft legislative guide takes the view that it is unnecessary for the UNLLO legislation to specify every aspect of the UNLLO's operations, and instead leaves it to members to decide in their members' agreement on the details concerning the management of the UNLLO. In order to manage the UNLLO fairly, effectively and transparently, members may wish to agree in the members' agreement on rules in respect of the following issues:⁸

(a) That as is reasonable in the circumstances, timely records should be kept 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;⁹

(b) Any requirement in respect of members' meetings, including their frequency and location, as well as any limitation thereon;

(c) Any requirement in terms of who can call a members' meeting;

(d) The conduct of members' meetings, including whether they may be held by technological means or by written consent;

(e) Any notice period required prior to the holding of a members' meeting;

(f) In what form any required notice of the members' meeting should be provided (for example, in writing or in any other form), and what information (if any) should be attached to the notice (for example, the UNLLO's financial information);

(g) Whether waiver of any required notice is permitted and what form that waiver may take; and

(h) Any decisions that would require a majority that differs from the default rule of simple majority for decisions in the ordinary course of business or unanimity for decisions outside of the ordinary course of business of the UNLLO.

⁷ See, also, para. 21 of A/CN.9/WG.I/WP.82.

⁸ As agreed by the Working Group at its twenty-sixth session (New York, April 2016) (paras. 39 to 47, A/CN.9/866).

⁹ As agreed by the Working Group at its twenty-sixth session (New York, April 2016) (para. 44, A/CN.9/866). For additional detail or the form in which such records should be maintained, see paras. 56-57 and draft recommendation 26 below.

Recommendation 13: The law should provide that, unless otherwise agreed:

(a) The members of the UNLLO have equal rights to manage the UNLLO;

(b) Any difference arising between members as to matters in the ordinary course of the activities and affairs of the UNLLO shall be decided by simple majority; and

(c) Any difference arising between members as to matters outside of the ordinary course of the activities and affairs of the UNLLO shall require unanimous consent.

D. Managers

12. Fiduciary duties tend to be broad standards of performance that reduce the risk of a member or a manager acting opportunistically, and encourage that person to act instead in favour of promoting the welfare of the UNLLO, and, indirectly, its members. Such duties may be separated into: (1) a duty of care; (2) a duty of loyalty, including a duty to refrain from self-dealing transactions, personal use of business assets, usurpation of enterprise opportunities, and competition with the UNLLO; (3) a duty to disclose information; and (4) a duty of good faith and fair dealing. The inclusion of such duties tend to be a standard feature of business associations law; for example, fiduciary duties are found in each of the simplified corporate forms examined by the Working Group when it first took up its mandate.¹⁰

13. Fiduciary duties offer protection against a manager's pursuit of personal interest and any excessively negligent behaviour on their part. However, fiduciary duties cannot be used to discipline managers in the performance of their official duties and thus subject their business judgement to criticism after the fact. Members could also agree to include in their members' agreement a provision that they owe fiduciary duties to each other.

14. Since this draft legislative guide is built on the premise that freedom of contract should to a large extent govern the internal governance structure of the UNLLO, the freedom of contract principle also applies to fiduciary duties, but only to an extent: the rule establishing a manager's duties in draft recommendation 14 is mandatory and members cannot contract out of it. Members are free, however, to establish in their members' agreement that a fiduciary duty is owed to each other or that a manager must adhere to a standard that is higher than that established in draft recommendation 14.

15. Similarly, members may specify in their agreement that certain activities are permitted for managers and do not constitute a breach of the duties established in draft recommendation 14. Such agreement, however, would not include eliminating or limiting the liability of a manager: (i) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; or (ii) for any

¹⁰ See paras. 24 and 25 and the corresponding tables in A/CN.9/WG.I/WP.82, considered at the twenty-second session of the Working Group (February 2014).

transaction from which the manager derived an improper personal benefit.¹¹ Permitting freedom of contract of the members to this extent could be expected to be useful in the context of UNLLOs, since this approach would allow members to derogate from a rigid corporate legal framework which may not be necessary in the UNLLO context, while still requiring appropriate protection for the UNLLO, its members and third parties dealing with it.

16. While this draft legislative guide provides contractual flexibility with respect to clarifying aspects of the fiduciary duties owed, it nonetheless contains broad standards of the performance expected from a manager. The following fundamental aspects of the fiduciary duties owed by a manager are thought to be included in this legislative guide through draft recommendations 14 and 27: (1) a duty to act in good faith and reasonably in the best interests of the UNLLO; (2) a duty to preclude from self-dealing transactions, personal use of assets of the UNLLO, usurpation of opportunities of the UNLLO, and competition with the simplified business entity; and (3) a duty to disclose information to all members of the UNLLO.¹²

Recommendation 14: The law should provide that a manager¹³ of the UNLLO must act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner that the manager reasonably believes to be in the best interests of the UNLLO.

17. Each manager of the UNLLO, whether member-managed or manager-managed, has the authority to legally bind the UNLLO. It is for that reason that the name of each manager must be included in the publicly disclosed information required for the formation of the UNLLO under draft recommendation 9. The disclosure of such information provides important protection to third parties dealing with the UNLLO. In most cases, the UNLLO will be member-managed, and each member will be authorised to legally bind the UNLLO.¹⁴

18. Restrictions may be agreed upon in the members' agreement in respect of the extent to which each manager can bind the UNLLO (for example, only up to a certain monetary threshold), or to vary the default rule that each manager can legally bind the UNLLO. Such modifications of the default rules will be effective as between the members of the UNLLO. However, such restrictions or variations will not be effective as 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 publicly disclosed manager,

¹¹ Similar approaches may be found in various legislative enactments in respect of fiduciary duties. For example, the United States Revised Uniform Limited Liability 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.

¹² These aspects were previously identified as important duties owed by the manager in paragraph 40, A/CN.9/WG.I/WP.89.

¹³ Again, it should be recalled that the term "manager" refers to both a member-manager and a manager-manager.

¹⁴ Clearly, it is not necessary for the members to name a board of management, but they may do so according to the members' agreement as agreed by the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 84(a), A/CN.9/860).

the UNLLO will nonetheless be bound by a decision in the ordinary course 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 publicly disclosed manager¹⁵ individually has the authority to bind the UNLLO.

19. The members may establish rules in their members' agreement for the appointment and removal of a manager.¹⁶ In the absence of such agreement, draft recommendation 16 provides a default rule that such decisions should be made by a simple majority of the members.

20. In the case of a manager-managed UNLLO, should a manager become unavailable (through death or otherwise), the members would be required to appoint another manager under the terms of the members' agreement. Appointing another manager would be important to ensure that amendments to the UNLLO's formation information, including the name of each manager (draft recommendation 9(a)(iv)) can validly be made pursuant to draft recommendation 10.

Recommendation 16: The law should provide that, unless otherwise agreed by the members, a manager or managers may be elected and removed by a simple majority decision of the members.

E. Contributions

21. Since the UNLLO is not required to have a capital structure, it is not necessary that members make contributions to it in order for it to exist. The UNLLO need not necessarily have assets at its formation, since assets would be generated through its operations. As such, the default rule in this draft legislative guide is that members are not required to make contributions to the UNLLO.

22. Of course, members may contract out of the default rule established in draft recommendation 17, and in their members' agreement they may choose to establish what each member will provide to the UNLLO by way of contribution (see draft recommendation 18 below).¹⁷

Recommendation 17: The law should provide that, unless otherwise agreed, a member of the UNLLO is not required to make a contribution to it in order to be a member.

23. Draft recommendation 18 of the legislative guide further elaborates on draft recommendation 17 by requiring the law to permit members maximum flexibility to decide upon the amount and type of their agreed contributions to the UNLLO.¹⁸ It is recommended that members maintain a central record of the amount and type of

¹⁵ Once more, it should be noted that the term "manager" refers to both a member-manager and a manager-manager.

¹⁶ As agreed by the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 84(d), A/CN.9/860).

¹⁷ As considered generally and agreed by the Working Group at its twenty-fourth session (New York, April 2015) (see para. 29, A/CN.9/831).

¹⁸ As agreed by the Working Group at its previous sessions (para. 29 of A/CN.9/831 and para. 34, A/CN.9/866).

contribution of each member to ensure that the rights of the members are respected (see also draft recommendations 26 and 27 below).

24. In specifying in their members' agreement the types of contribution that members of the UNLLO may make, members may wish to consider the following possibilities: tangible or intangible property or 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 it is generally encouraged that members should be permitted great flexibility in determining for themselves what type of contributions to the UNLLO would be appropriate, in some cases, local law may restrict the types of contribution that may be made. For example, in some States, it is not permitted to use the provision of services as a contribution to the establishment of a business entity. In such cases, those restrictions may be specified in the law prepared on the basis of this draft legislative guide.¹⁹

25. Where members agree to make contributions to the UNLLO, but do not specify the amount of the contributions, draft recommendation 18 provides that, in keeping with the general approach to ownership²⁰ and management of the UNLLO, contributions should be made by each member in an equal amount.²¹

26. Moreover, 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 the value of their contributions.²² 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.²³

27. It should also be noted that more complex ownership²⁴ structures could be established by the members in their agreement, including by way of agreement on

¹⁹ As agreed by the Working Group at its twenty-sixth session (New York, April 2016) (paras. 34 to 35, A/CN.9/866).

²⁰ The Working Group agreed at its twenty-sixth session (New York, April 2016) that in order to achieve a common understanding, the next draft of the text should explain what was meant by the term "share", and should present possible alternatives for more neutral terms (para. 25, A/CN.9/866). Since this draft legislative guide attempts to create a system for a legal business form that is not dependent on the corporate model, it refers to "interest" and "ownership" to indicate that portion of the UNLLO that is owned by a particular member.

²¹ As agreed by the Working Group at its twenty-sixth session (New York, April 2016) (para. 34, A/CN.9/866).

²² As agreed by the Working Group at its twenty-sixth session (New York, April 2016) (para. 34, A/CN.9/866).

²³ As agreed by the Working Group at its twenty-sixth session (New York, April 2016) (para. 37, A/CN.9/866).

²⁴ The Working Group agreed at its twenty-sixth session (New York, April 2016) that in order to achieve a common understanding, the next draft of the text should explain what was meant by the term "share", and should present possible alternatives for more neutral terms (para. 25, A/CN.9/866). Since this draft legislative guide attempts to create a system for a legal business form that is not dependent on the corporate model, it refers to "interest" and "ownership" to indicate that portion of the UNLLO that is owned by a particular member.

different classes and types of membership,²⁵ as well as on special rights that might attach to such different classes of membership.

Recommendation 18: The law should provide that members are permitted to agree upon contributions made to the UNLLO, including the amount and type of such contributions, but that in the absence of such agreement, contributions that are made to the UNLLO should be made in equal amounts by the members.

F. Distributions

28. In keeping with the general default approach of the UNLLO, this draft legislative guide provides that unless the members of an UNLLO have otherwise agreed in their members' agreement, members will share equally in the ownership of the UNLLO and in any distributions made by it.²⁶

29. The members of the UNLLO may also agree on the type of distribution (for example, including cash or property of the UNLLO) as well when such distributions may be made. It is important to note, however, that some States may not permit non-monetary distributions and that, in such cases, States should specify those restrictions in the UNLLO law enacted on the basis of this draft legislative guide.

Recommendation 19: The law should provide that, unless otherwise agreed, any distribution by the UNLLO shall be made equally among its members.

30. Although the amount, type and timing of distributions may be subject to the members' agreement, this draft legislative guide includes mandatory provisions governing distributions aimed at protecting third parties dealing with the UNLLO. In order to protect such parties, the members of the UNLLO cannot contract out of the rule prohibiting distributions from being made by the UNLLO when such a distribution would violate either an insolvency test, as reflected in draft recommendation 20(a), or a balance sheet test, as reflected in draft recommendation 20(b). Under the insolvency test, the UNLLO must still be able to pay its debts upon giving effect to the distribution, while the balance sheet test ensures that distributions can only be made if the UNLLO's remaining assets exceed its total liabilities. At previous sessions of the Working Group, a concern was expressed as to whether the insolvency and balance sheet tests were appropriate for MSMEs or if they might be too complex, but no decision was reached in that regard.²⁷ The Working Group may wish to note that, on their face, these tests may appear to be

²⁵ The Working Group agreed at its twenty-sixth session (New York, April 2016) that this draft legislative guide should start with the simplest model and should establish the default rule to be one of equal voting rights and equal distributions, unless otherwise agreed in the members' agreement. The Working Group also agreed that this legislative guide should permit the establishment of more complex ownership structures, including special rights, which could be mentioned in the commentary (paras. 27 and 29, A/CN.9/866).

²⁶ The Working Group agreed at its twenty-sixth session (New York, April 2016) that this draft legislative guide should start with the simplest model and should establish the default rule to be one of equal voting rights and equal distributions, unless otherwise agreed in the members' agreement (para. 27, A/CN.9/866). See, also, the discussion of including a default rule for distributions at para. 32 of A/CN.9/831.

²⁷ See para. 31, A/CN.9/831 and para. 30, A/CN.9/866.

more complex than they are, since most MSMEs are able to track their financial status quite accurately, and may even rely on the many simple mobile applications that exist for such purposes.

31. This mandatory rule, in conjunction with the clawback provision in draft recommendation 21, 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.

32. This draft legislative guide does not contain a specific provision holding managers liable for making improper distributions.²⁸ In most cases, the UNLLO will be member-managed, and it is submitted that holding each member liable in draft recommendation 21 to return the entire amount of the improper distribution should act as an adequate disincentive for the member-managed situation. Where the UNLLO is manager-managed, the duties set out draft recommendation 14 along with draft recommendations 20 and 21 should provide an adequate basis on which to find managers liable should they make improper distributions.

Recommendation 20: 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 usual course of business; or

(b) The UNLLO's total assets would be less than the sum of its total liabilities.

33. In keeping with the rule on improper distributions established in draft recommendation 20, draft recommendation 21 provides an operative provision that permits the entire amount of any such distribution to be clawed back from each member who received that distribution, or any portion of it. Such a rule is intended both to protect third parties dealing with the UNLLO and to provide an incentive to members to ensure that any distributions made to them would not leave the UNLLO insolvent or with greater liabilities than assets.

34. It should be noted that payments of reasonable compensation for services rendered²⁹ and for bona fide debt owed by the UNLLO to a member should not be considered as distributions, and would thus not be subject to the clawback provision in draft recommendation 21.

35. In addition, as noted in para. 32 above, managers that make distributions in violation of one of the tests in draft recommendation 20 could also be held liable for that decision pursuant to the managers' duties set out in draft recommendation 14.

Recommendation 21: The law should provide that each member who received a distribution, or any portion of a distribution, made in violation of recommendation 20 is liable to reimburse the UNLLO for the entire amount of that distribution.

²⁸ See the discussion of the Working Group at its previous sessions (para. 32 of A/CN.9/831 and para. 33, A/CN.9/866).

²⁹ See para. 30, A/CN.9/866.

G. Transfer of rights

36. Because of the nature of the UNLLO as a micro or small business that is privately held, its members are likely to value the composition of its membership and to resist transfers of ownership without the approval of other members. In addition, there is unlikely to be a ready market for the sale and transfer of an ownership interest in an UNLLO.

37. The ownership stake of an UNLLO member entitles it to exercise two sets of rights: financial rights to share in the profits and losses of the UNLLO and to receive distributions, and governance rights to participate in the management and control of the UNLLO, including fiduciary rights and information rights. Moreover, the default rule for most aspects of the UNLLO as established in this draft legislative guide is that members share in rights on an equal basis.

38. Consistent with this general approach, and in light of the likely context of the UNLLO, the default rule should be that members of the UNLLO are permitted to transfer their financial rights, unless they have agreed otherwise in their members' agreement. Also bearing in mind the general nature of UNLLOs, the default rule in respect of the transfer of governance rights in the UNLLO should be that such rights are not transferable by members unless they have agreed otherwise in their members' agreement. This latter rule in respect of governance rights reflects the idea that, given the particular characteristics of the UNLLO, non-transferring members must consent to changes in the management and control of the UNLLO. These rules are reflected in draft recommendation 22.

39. 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.

Recommendation 22: The law should provide that members may transfer their financial rights in the UNLLO, but that they may not transfer their non-financial rights in the UNLLO. Members of the UNLLO may vary this rule by agreement.

H. Restructuring or conversion

40. As noted above (in para. 53, A/CN.9/WG.I/WP.99) in respect of draft recommendation 7, this draft legislative guide is intended to permit the UNLLO to evolve from a very small single member enterprise to a more complex multi-member business entity,³⁰ and possibly to convert into another legal business form altogether. That approach is reflected in draft recommendation 23, which permits the members of the UNLLO to agree to restructure the UNLLO or to convert it into a different legal form.

41. As noted above in para. 10 in connection with draft recommendation 13, a decision on the restructuring or conversion of the UNLLO would be a decision

³⁰ See paras. 24 and 32 of A/CN.9/800, paras. 67 and 74 of A/CN.9/825, and para. 19 of A/CN.9/831.

outside of the ordinary course of business, and would thus require unanimous consent, unless otherwise agreed by the members.³¹

42. 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. Such safeguards may already exist in legislation providing for conversion into other legal business forms,³² and could consist, for example, of notice periods, publication requirements or rules on the transfer of third party rights to the new business form.

Recommendation 23: The law should provide that the members of an UNLLO may restructure it or convert it into another business form by agreement.

I. Dissolution and winding-up

43. Draft recommendation 24, paragraph (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 unanimous consent to dissolve and wind up the entity as indicated in paragraph (b) of draft recommendation 24. 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.³³

44. Draft recommendation 24, paragraph (c), is a mandatory rule that members are not entitled to 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 a bankruptcy court.³⁴

45. 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 dealing with the UNLLO from any adverse effects that could arise from its dissolution or winding-up. Such safeguards may already exist in other legislation providing for dissolution or winding-up of legal business forms.³⁵

³¹ As agreed by the Working Group at its twenty-fifth session (Vienna, October 2015), the level of agreement among members for restructure and conversion of the UNLLO should be commensurate with that required for dissolution and winding-up of the UNLLO (para. 90, A/CN.9/860).

³² As agreed by the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 91, A/CN.9/860).

³³ As agreed by the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 87, A/CN.9/860).

³⁴ As agreed by the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 85, A/CN.9/860).

³⁵ As agreed by the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 86, A/CN.9/860). See, also, para. 42 above.

Recommendation 24: 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 the unanimous consent of the members; or**
- (c) Upon the rendering of a judicial or administrative decision that the UNLLO is dissolved.**

J. Dissociation or withdrawal

46. Members of an UNLLO will often have equal financial and managerial control rights; indeed, that is the default rule that runs throughout this legislative guide. It is further reflected in the fact that the default rule is that decisions made outside of the ordinary course of the activities and affairs of the UNLLO require the unanimous consent of the members (draft recommendation 13(c)). As noted above, 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, dissolution and winding-up. Similarly, the default rule for resolving differences among members on matters in the ordinary course of business of the UNLLO is that such matters may be decided by a simple majority of members (draft recommendation 13(b)), thus providing a convenient way to resolve more routine differences of view amongst the UNLLO members. These two default rules provide a reasonable, coherent and stable decision-making system for members to resolve basic disputes and to continue to conduct the affairs of the UNLLO, as well as effectively providing a veto for any member that does not agree with important decisions that could affect the very existence of the UNLLO.

47. However, once dissatisfaction or distrust disrupts their relationship, members of the UNLLO may not find these default decision-making mechanisms to be adequate and they may be unable to negotiate their way out of the dispute. Members may not have foreseen the possibility of such an intractable dispute, and may not have provided a mechanism for its resolution in their members' agreement. As such, the UNLLO legislation should include a default rule for dealing with such disputes.

48. One approach 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 the UNLLO to continue its existence and would thus result in a net loss in economic value.

49. A second approach to dealing with such intractable member disputes would be to facilitate the continued existence of the UNLLO, instead permitting members to withdraw or to be expelled from the UNLLO and to receive the fair value of their ownership interest. However, the disadvantage of permitting members to expel another member is that 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 ownership or to sell it back to the majority members for whatever price the majority was willing to offer.

50. Draft recommendation 25 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. In this outcome, unless the members vote unanimously otherwise, the UNLLO continues to exist, thus preserving both economic stability and value. Moreover, permitting the payment of the fair value of the withdrawing member's ownership interest over time avoids a situation where the withdrawing member could hold the UNLLO and its remaining members to ransom by demanding immediate payment of the entire amount. Complying with an immediate demand of that sort might not be possible for the UNLLO or its remaining members, and could effectively force the dissolution of the UNLLO by rendering it insolvent.

51. The default rule suggested in draft recommendation 25 may still present challenges in terms of assessing the fair value of the withdrawing member's interest. The starting point for that valuation should obviously be that the dissociating 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 member withdrawing should thus be the greater of that member's share of the liquidation value of the UNLLO or a value based on the sale of the entire UNLLO as a going concern.

52. It would also be prudent for members to decide in their members' agreement to use alternative dispute resolution (including arbitration and mediation) for matters that cannot be resolved through the application of the members' agreement or the default rules.³⁶ Agreement on the fair valuation of a withdrawing member's interest could be one of the issues that might be referred for alternative dispute resolution.

Recommendation 25: 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 interest in the UNLLO.

K. Record-keeping, inspection and disclosure

53. 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 share equal ownership and management rights, 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

³⁶ This approach would cover disputes arising between members of the UNLLO, but it might not sufficiently cover the issue of disputes involving the UNLLO and third parties. As discussed by the Working Group at its twenty-second session (New York, February 2014), various other models could be considered for dispute resolution involving UNLLOs and third parties, including the establishment of special dispute resolution bodies, or examining ways to make existing dispute resolution mechanisms more accessible for MSMEs, for example, in respect of arbitration, mediation and insolvency (see paras. 60 to 62, A/CN.9/800 and paras. 38 to 40, A/CN.9/WG.I/WP.82). It is suggested that in order to avoid unnecessary complexity in this draft UNLLO legislative guide, such issues could be considered in relation to matters as they may arise in other UNCITRAL Working Groups, for example, in respect of the MSME work of Working Group V on insolvency, as already mandated by the Commission.

decision-making processes, thus providing a strong basis for the positive performance of the UNLLO.

54. Mandatory rules for the establishment of these principles are set out in draft recommendation 26, which requires the UNLLO to keep certain information, and draft recommendation 27, which ensures that each member has the right to inspect the information kept by the UNLLO, as well as the right to access any other reasonable information regarding the UNLLO, including information on its activities, operations and financial situation.³⁷ The importance of sharing and disseminating information on the UNLLO among its members is emphasised in that the members cannot contract out of the mandatory rules established in draft recommendations 26 and 27. However, members can agree by contract that the UNLLO should retain information in addition to that required in draft recommendation 26.

55. While the focus of the UNLLO is on 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 restrict mandatory disclosure to public business entities. The approach taken in this legislative guide is that only the information required for formation of the UNLLO in draft recommendation 9(a) must be made public, and that the information that must be retained by the UNLLO further to draft recommendation 26 need not be publicly disclosed,³⁸ although it should be shared with all members and subject to their inspection.

56. The list of records that must be kept pursuant to draft recommendation 26 should not be particularly burdensome for UNLLOs, even when they are MSMEs, in that it consists of the most 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 draft 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.

57. For example, many MSMEs use various mobile applications that are available on electronic devices to run their commercial enterprises, and are thus able easily to track and access all types of information relevant to the business, including

³⁷ As agreed by the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 93(b), A/CN.9/860).

³⁸ While privately held businesses, like UNLLOs, are not required to provide the same flow and rate of information as publicly held firms generally, they may have strong incentives for doing so, particularly as they develop and progress. Indeed, businesses wishing to improve their access to credit or to attract investment may wish to signal their accountability by supplying information about: (1) the business’ objectives; (2) principal changes; (3) balance sheet and off-balance sheet items; (4) its financial position and capital needs; (5) the composition of any management board and its policy for appointments and remuneration; (6) forward-looking expectations; and (7) profits and dividends. Such considerations are not likely to trouble the smaller enterprises contemplated as the main users of the UNLLO, but could be important for those businesses as they grow. See, also, the agreement of the Working Group at its twenty-fifth session (Vienna, October 2015) (para. 84(d), A/CN.9/860).

inventory, simple balance sheets, and even tax returns. An UNLLO operating in that context could then satisfy the requirements of draft recommendations 26 and 27 through retaining and permitting access to the information electronically available via that mobile application.

Recommendation 26: The law should provide that the UNLLO must keep reasonable records in respect of:

- (a) Its formation information;**
- (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, as well as its financial information.**

Recommendation 27: The law should provide that each member has the right to inspect and copy any of the records required to be kept by the UNLLO in recommendation 26, and to obtain from the UNLLO information concerning its activities, operations and financial information, as well as any other reasonable information in respect of the UNLLO.³⁹

³⁹ As agreed by the Working Group at its twenty-fifth session in respect of its financial information (Vienna, October 2015) (para. 93(b), A/CN.9/860).

Annex I

Draft recommendations on an UNLLO

I. 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, if any.

Recommendation 2: The law should provide that an UNLLO may be organised for any lawful activity.

Recommendation 3: The law should provide that the UNLLO has a legal personality.

Recommendation 4: The law should provide that, unless otherwise agreed,⁴⁰ a member is not liable for any obligation of the UNLLO solely by reason of being a member of that UNLLO.

Recommendation 5: The law should not contain a minimum capital requirement 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.

II. Formation of the UNLLO

Recommendation 7: The law should provide that the UNLLO must have at least one member from the time of its formation until its dissolution, and that any person may be a member of the UNLLO.

Recommendation 8: The law should specify the time of formation of the UNLLO.

Recommendation 9: The law should provide that only the following information is required for valid formation of the UNLLO:

(a) Information that will be made public:

(i) The name of the UNLLO;

(ii) The business address or precise geographical location of the UNLLO;

⁴⁰ If the Working Group is of the view that the draft recommendation would be clearer if these two concepts were separated from each other (see also the discussion of the Working Group reflected in para. 52 of A/CN.9/831), the draft recommendation could appear in two parts as follows:

“Recommendation 4.1: 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 the UNLLO.”

“Recommendation 4.2: The law should provide that members may agree that one or more members will be personally liable for the obligations of the UNLLO in the circumstances specified in the members’ agreement.”

(iii) A statement of whether the UNLLO is member-managed or manager-managed; and

(iv) The name of each manager;⁴¹ and

(b) Information that will not be made public: the name and address of each member.

Recommendation 10: The law should provide that the formation information may be amended by any manager, unless otherwise agreed by the members.

III. Organization of the UNLLO

Recommendation 11: 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 established by way of conduct. The members may agree in their members' agreement on any matter relating to the UNLLO, except in respect of the mandatory rules set out in recommendations 1, 2, 3, 6, 7, 8, 9, 14, 15, 20, 21, 24(c), 26 and 27.

Recommendation 12: The law should provide that the UNLLO is member-managed by all members, unless otherwise agreed.

Recommendation 13: The law should provide that, unless otherwise agreed:

(a) The members of the UNLLO have equal rights to manage the UNLLO;

(b) Any difference arising between members as to matters in the ordinary course of the activities and affairs of the UNLLO shall be decided by simple majority; and

(c) Any difference arising between members as to matters outside of the ordinary course of the activities and affairs of the UNLLO shall require unanimous consent.

IV. Managers

Recommendation 14: The law should provide that a manager⁴² of the UNLLO must act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner that the manager reasonably believes to be in the best interests of the UNLLO.

Recommendation 15: The law should provide that each manager⁴³ individually has the authority to bind the UNLLO.

⁴¹ Of course, the term "manager" in this draft legislative guide refers to both a member-manager and a manager-manager.

⁴² Again, it should be recalled that the term "manager" refers to both a member-manager and a manager-manager.

⁴³ Once more, it should be noted that the term "manager" refers to both a member-manager and a manager-manager.

Recommendation 16: The law should provide that, unless otherwise agreed by the members, a manager or managers may be elected and removed by a simple majority decision of the members.

V. Contributions

Recommendation 17: The law should provide that, unless otherwise agreed, a member of the UNLLO is not required to make a contribution to it in order to be a member.

Recommendation 18: The law should provide that members are permitted to agree upon contributions made to the UNLLO, including the amount and type of such contributions, but that in the absence of such agreement, contributions that are made to the UNLLO should be made in equal amounts by the members.

VI. Distributions

Recommendation 19: The law should provide that, unless otherwise agreed, any distribution by the UNLLO shall be made equally among its members.

Recommendation 20: 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 usual course of business; or

(b) The UNLLO's total assets would be less than the sum of its total liabilities.

Recommendation 21: The law should provide that each member who received a distribution, or any portion of a distribution, made in violation of recommendation 20 is liable to reimburse the UNLLO for the entire amount of that distribution.

VII. Transfer of rights

Recommendation 22: The law should provide that members may transfer their financial rights in the UNLLO, but that they may not transfer their non-financial rights in the UNLLO. Members of the UNLLO may vary this rule by agreement.

VIII. Restructuring or conversion

Recommendation 23: The law should provide that the members of an UNLLO may restructure it or convert it into another business form by agreement.

IX. Dissolution and winding-up

Recommendation 24: 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 the unanimous consent of the members; or
- (c) Upon the rendering of a judicial or administrative decision that the UNLLO is dissolved.

X. Dissociation or withdrawal

Recommendation 25: 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 interest in the UNLLO.

XI. Record-keeping, inspection and disclosure

Recommendation 26: The law should provide that the UNLLO must keep reasonable records in respect of:

- (a) Its formation information;
- (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, as well as its financial information.

Recommendation 27: The law should provide that each member has the right to inspect and copy any of the records required to be kept by the UNLLO in recommendation 26, and to obtain from the UNLLO information concerning its activities, operations and financial information, as well as any other reasonable information in respect of the UNLLO.⁴⁴

⁴⁴ As agreed by the Working Group at its twenty-fifth session in respect of its financial information (Vienna, October 2015) (para. 93(b), A/CN.9/860).