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Micro, small and medium-sized enterprises

Draft model law on a single-member business entity

Note by the Secretariat

Addendum

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I. Introduction

1. As noted in A/CN.9/WG.I/WP.86 (paras. 3 to 4), at its first session, the Working Group emphasized the importance of focussing on the needs of micro businesses in its consideration of the legal issues surrounding the simplification of incorporation. In order to offer the advantages of limited liability, legal personality and freedom of contract to micro-businesses, but to take a simple, low-cost approach, a “think small first” methodology was taken. In that vein, the attached text of a draft model law on single-member businesses enterprises has been prepared.

2. The vast majority of enterprises in the world are one-person businesses. In light of the forces of globalization and economic integration, it is important to strengthen the economic role and position of these businesses, which are usually microenterprises. What legal structure can be created to help these enterprises thrive? When it comes to the organization of these entities, two distinct approaches may be identified. First, many¹ States have modernized and simplified the laws that govern business entities. Second, initiatives have been launched under which smaller enterprises receive certain incentives, including registration exemptions and tax benefits.

3. Against this background, the following questions may be relevant for the consideration of the Working Group: (1) would microenterprises prefer to select a redesigned, but already existing business form; (2) would newly introduced legal forms be better positioned to offer ready-made structures in which smaller enterprises could easily be started; and (3) how many types of legal forms should be made available? There are no uniform answers to these questions, since the list of available legal business forms for privately held entities of all sizes differs from State to State.

4. In this context, a model law on legal business forms should ideally offer enacting States the choice to adopt the model as a unified statute; this approach would clearly achieve the greatest level of harmonization. However, since States may have already enacted business forms for microenterprises or be in the process of doing so, such States could choose to implement one or more features of the draft model law by amending their statutes or legislative drafts. In order to reflect the flexibility of and options open to States in implementing the attached draft model law, the term “business entity” is introduced to capture a range of possible enterprises.

5. The draft model law builds on the presumption that a legislative regime for a ready-made business form should focus on the needs of the smallest one-person entities first (the “think small first” principle). It should be noted that the current draft of the model law does not yet contain definitions nor does it refer to any standard forms; either could be added at a later date, once the Working Group has considered whether or not it wishes to further develop the draft model law.

¹ For current details, information may be obtained at: www.doingbusiness.org/reforms.

II. Text of a draft model law on a single-member business entity

Chapter I — General provisions

Article 1. Nature

A single-member business entity may be organized under this law for any lawful activity, including the ownership of property, subject to any law of [insert the enacting State] governing or regulating such activities.

6. *Comment* — A single-member business entity may be organized for any lawful purpose unless the enacting State has specifically prohibited a single-member business entity from engaging in a specific activity or in certain regulated industries, such as the banking or insurance industry. If an enacting State wishes to prohibit or exclude certain activities of a single-member business entity (or, for example, to limit its operation to commercial activities), it could be accomplished by adjusting this provision.

Article 2. Legal personality

A single-member business entity is an entity distinct from its sole member. A single-member business entity has the capacity to sue and be sued in its own name and the power to do all things necessary or convenient to carry on its activities.

7. *Comment* — The draft model law on a single-member business entity embraces the legal personality approach in order to give a clear expression to the nature of the business form as a legal entity separate from its members. The status of a single-member business entity for tax purposes should not affect its status as a separate legal entity formed under the draft model law.
8. The draft model law takes the view that the separation between the assets of the single-member business entity and the personal assets of the single-member who owns the business entity is the defining characteristic of the legal personality status.

Article 3. Limited liability

Except as provided by the operating document, if any, the single-member is not solely by reason of being a member liable to any person, directly or indirectly, by contribution, indemnity or otherwise, for any obligation of the single-member business entity.

9. *Comment* — The term “operating document” is the document or electronic record that governs the affairs of a single-member business entity. The operating document, if any, should not have to be filed or disclosed; this is in order to protect privacy and to avoid the need to file amendments with the authorities should the single-member wish to change the entity’s operating document. As stated in article 6 of the draft model law, a single-member business entity is formed by executing and filing a “formation document” which requires the disclosure of only a few facts, including the name of the single-member business entity. In the case of most single-member business entities, the single-member will also act as the sole

manager and an operating document will not be necessary. The simplicity of such an arrangement should make it more attractive to micro-business sole proprietors.

10. In order to offer a clear and simple framework to economic actors, the single-member business entity offers limited liability protection to its member. The presence of a liability shield generally prevents the single-member from incurring personal liability as a result of activities of the single-member business entity in the ordinary course of the business.

11. There is a wide range of academic literature that suggests that the presence of limited liability introduces the prospect of opportunistic behaviour, i.e., attempts by a member to shift the risk of business failure to third parties or outsiders. Some have suggested that limited liability should not be considered as an essential feature of business entities. Others are of the view that uncertainty surrounding the efficiency of limited liability lends support to introducing special rules and regulations, such as minimum capital and capital maintenance requirements, to protect voluntary and involuntary creditors to the firm (such as tort creditors). However, the reliance on minimum capital requirements to balance the levels of risk-taking may be deceptive. By their very nature, these requirements may impede innovation, business entry and investment, and may consequently create unnecessary barriers to trade and social welfare.

12. In order to provide some protection to creditors and to third parties dealing with the entity, the draft model law includes the principle that the member will incur liability for improper distributions as well as an obligation for the member to repay the single-member business entity for any improper distributions (article 8).

Article 4. Name of entity

1. The name of the single-member business entity must contain the phrase “single-member business entity” or the abbreviation “SBE”.

2. The name of the single-member business entity must be distinguishable upon the records of the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*] from the name of any other registered legal entity in [*insert the enacting State*], unless the use of the name is authorized by the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

13. *Comment* — This article is included because certain States provide for the registration (and approval) of company names to enable the appropriate commercial registry or other body administering business associations under the law of the enacting State to prevent the proposed name of the single-member business entity from conflicting with the name of another entity or any trade names.

14. Enacting States may include an article stating that a person may reserve the exclusive use of a name by delivering an application to the appropriate commercial registry or other body administering business associations under the law of the enacting State.

15. The provision in paragraph 2 allowing authorities to authorize the use of a name similar to or indistinguishable from that of another business entity is best understood in the context of micro and small businesses, where two entities could

possess similar names but be engaged in very different industries and/or distant geographical areas, and thus be quite distinguishable in fact.

Chapter II — Formation and proof of existence

Article 5. Formation of a single-member business entity

1. One natural person may form a single-member business entity by executing a formation document and delivering it to the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].
 2. Unless a future effective date not more than 90 days after the delivery of the formation document is specified in the formation document, the existence of the single-member business entity begins when the formation document is executed and delivered to [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].
 3. A single-member business entity is formed at the time of execution and delivery of the formation document or at a future date specified in the formation document but not more than 90 days after the delivery of the formation document, if there has been compliance with the requirements of article 6.
16. *Comment* — In some enacting States, the formation procedure must be coupled with review of the formal correctness of the formation document by a court, administrative agency or notary, and in such cases, paragraphs 1 and 2 may be adjusted accordingly.
17. Ideally, delivery of the formation document may also be accomplished electronically provided that the information can be retrieved in printed form or in a manner so as to be usable for subsequent reference. If a future effective date not more than 90 days after delivery of the formation document is specified, it is on that date that the existence of the single-member business entity begins. The electronic filing of formation documents enables legal entities to be created without the intervention of professionals, and it might be argued that this trend could increase the potential for misuse of the legal entity (e.g., money-laundering and terrorist financing; see, also, A/CN.9/WG.I/WP.82, paras. 26 to 32). However, it should be recalled that legal entities, in order to conduct activities, often have to 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.
18. Article 5(1) allows only natural persons to create a single-member business entity, as this would be the most likely scenario in respect of a micro-business. It would, of course, be possible to extend this provision to include legal persons as well.

Article 6. Formation document

1. The formation document must set forth:
 - (a) The name of the single-member business entity;

(b) The street address, if any, mailing address and domicile of the single-member business entity;

(c) The name and mailing or service address of each member of the board of management, if any; and

(d) The date on which the single-member business entity is to dissolve, if the single-member business entity is to have a specific date of dissolution.

2. The formation document may also set forth:

(a) Any provision for the management of the single-member business entity and for the conduct of the affairs of the single-member business entity;

(b) Any provision regarding the authority to bind and represent the single-member business entity; and

(c) Any other matters relating to the single-member business entity that the person forming the single-member business entity determines to include therein.

3. The formation document must be amended if the information required in paragraph 1 changes, and may be amended at any time for any purpose the single-member sees fit, by executing and delivering an amendment to [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

19. *Comment* — It is necessary to disclose the name and mailing address of the single-member and each member of the board of management (if any) in order to enable the appropriate commercial registry or other body administering business associations under the law of the enacting State to adequately monitor and observe their work in respect of the maintenance of the entity's books and records.

20. The single-member and possible members of the board of management of a single-member business entity are required only to provide a mailing or service address rather than a residential address to be registered and available to the public. If an enacting State decides to implement the requirement to provide the appropriate commercial registry or other body administering business associations under the law of the enacting State with a residential address, the residential address should not appear on the public registry (and should only be available to predetermined organizations such as governmental and credit reference agencies). The rationale behind this is that single-members and possible members of the board of management may feel that the public availability of their residential address presents a risk to their safety.

Chapter III — Capital

Article 7. Contributions

1. A contribution may consist of tangible or intangible property or other benefit to a single-member business entity, including money, services performed, promissory notes, other agreements to contribute money or property, and contracts for services to be performed.

2. A single-member's obligation to make a contribution to a single-member business entity is not excused by the single-member's death, disability, or

other inability to perform personally. If a single-member does not make a required contribution, the single-member or single-member's estate is obligated to contribute money equal to the value of the portion of the contribution that has not been made.

Article 8. Distributions

1. The single-member is entitled to receive distributions.
2. No distribution may be made if, after giving it effect: (a) the single-member business entity would not be able to pay its debts as they become due in the usual course of business; or (b) the single-member business entity's total assets would be less than the sum of its total liabilities.
3. Distributions may be paid in cash or in property of the single-member business entity.

Article 9. Liability for improper distributions

A single-member who receives a distribution in violation of article 8, paragraph 2 and who knew or ought reasonably to have known at the time of the distribution that the distribution violated article 8, paragraph 2, shall be liable to the single-member business entity for the amount of the distribution.

21. *Comment* — As mentioned in the comment under article 3, it has been observed that minimum capital and capital maintenance regimes may be largely ineffective and may create obstacles for economic actors to start a business. Against this background, enacting States may consider including rules in the area of distributions which assign liability rules for the single-member. Also, enacting States may wish to consider certain variations to the liability rules, such as a statutory obligation for the shareholder to return any distribution that was made to them within one year prior to bankruptcy.

22. The draft model law contains an “insolvency test” in combination with a “balance sheet test”. Under the insolvency test the single-member business entity must be able to pay its debts after giving effect to the distribution. The balance sheet test ensures that distributions are only made if the single-member business entity's total assets exceed its total liabilities.

Chapter IV — Organization of the single-member business entity

Article 10. Management of the single-member business entity

1. The business and affairs of every single-member business entity organized under this law shall be managed by the single-member, unless the formation document expressly provides that the management of the single-member business entity is or will be vested in a board of management.
2. An act outside the ordinary course of activities of the single-member business entity may be undertaken only by the single-member by way of written resolution, which must be kept in the records of the business entity for a minimum of 5 years.
3. If there is a board of management, it must consist of one or more natural persons. The number of members of the board of management, if any, shall be

fixed by or in the manner provided in the operating document, unless the formation document stipulates the number of members of the board of management, in which case a change in the number of members of the board of management may only be made through amendment of the formation document or as provided in the formation document.

4. The formation document or operating document may prescribe other qualifications for members of the board of management. Each member of the board of management shall hold office until such member's successor is appointed or until such member's earlier resignation or removal.

5. A member or members of the board of management, if any, must comply with the rules of procedure in the operating agreement, and must act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the interests of the business entity and its single-member.

6. Members of the board of management, if any, are appointed by the single-member, unless otherwise provided in the operating document.

7. Any member of the board of management or the entire board of management may be removed, with or without cause, by the single-member or by any other procedure established in the operating document, unless the formation document otherwise provides.

Article 11. Relations with persons dealing with the single-member business entity

A single-member shall have the power to bind and represent the single-member business entity, unless the formation agreement provides that the authority to bind and represent the single-member business entity rests with one or more members of the board of management, if any, or other persons appointed in the manner provided in the formation document. The members of the board of management or persons authorized to represent a single-member business entity may undertake all actions in the ordinary course of business unless the formation document states otherwise.

23. *Comment* — Although it is acknowledged that management activities are conducted by the single-member in most micro-businesses, the draft model law builds on the premise that flexibility should to a large extent govern the internal governance structure of the single-member business entity.

Chapter V — Restructuring

Article 12. Amendments to the operating document

The operating document may be amended only by a resolution of the single-member.

Article 13. Restructuring

1. A single-member business entity may only be converted into any other business form governed under the [*insert appropriate applicable law of enacting State, be it code, decree, law or regulation*] by a resolution of the single-member.
2. The [*insert appropriate applicable law of enacting State*] governing conversion into another form, mergers and split-off proceedings for business associations will be applicable to the single-member business entity.

Chapter VI — Dissolution and winding up

Article 14. Dissolution and winding up

1. The single-member business entity shall be dissolved and wound up whenever:
 - (a) An expiration date, term or event has been included in the formation document and such term has elapsed, provided that a determination to extend it has not been made by the single-member, before or after such expiration has taken place;
 - (b) Compulsory liquidation proceedings have been initiated;
 - (c) An event of dissolution set forth in the operating document has taken place;
 - (d) Such decision has been made by the will of the single-member;
 - (e) A decision to that effect has been rendered by any authority with jurisdiction over the single-member business entity; or
 - (f) Upon the death of the single-member.
2. Whenever an expiration term has elapsed, the single-member business entity shall be dissolved automatically. In all other cases, notice of the dissolution of the single-member business entity must be delivered to the [*insert the name of the appropriate commercial registry or other body administering business associations under the law of the enacting State*].

Article 15. Winding up

The single-member business entity will be wound up in accordance with the [*insert appropriate applicable law of enacting State, be it code, decree, law or regulation*]. The single-member shall act as liquidator unless the single-member, or, in case of the death of the single-member, the executor of the single-member, appoints any other person to wind up the business entity.

Chapter VII — Miscellaneous

Article 16. Financial statements

1. The single-member shall prepare financial statements and company accounts and keep them with the records of the business entity for a minimum of 5 years. If a board of management has been appointed, it shall prepare the

financial statements and company accounts for the approval of the single-member.

2. All financial statements referred to in this article shall meet the requirements of the accounting rules and other disclosure requirements of the [*insert appropriate applicable law of enacting State, be it code, decree, law or regulation*].

24. *Comment* — While the focus of the draft model law is on single-member business entities, disclosure and transparency are important issues facing any business organization. While some States apply broad disclosure requirements to closely held corporations (but allow exceptions to be made for small and medium-sized firms), others restrict mandatory disclosure to publicly held firms.² In any event, members of closely held entities are generally entitled to substantial information and a right to inspect the company books and records.

Article 17. Governing law

The single-member business entity shall be governed by:

- (a) This law;
- (b) The formation document; and
- (c) The operating document.

² While micro, small and medium-sized enterprises are not required to provide the same flow and rate of information as publicly held firms generally, arguably they should have strong incentives for doing so. Indeed, the best run companies, which are more attractive to investors, signal their accountability by supplying information about: (1) the company's objectives; (2) principal changes; (3) balance sheet and off-balance sheet items; (4) financial position of the firm and its capital needs; (5) composition of the management board and company policy for appointments and remuneration; (6) forward-looking expectations; and (7) profits and dividends. However, such considerations are not likely to trouble the micro and very small enterprises contemplated under this draft model law.