

Initial Responses to the Community Working Group's California Law Questions

7 February 2015

The below initial responses from Jones Day to questions submitted by the Cross Community Working Group (CCWG) set out a high level discussion of various aspects of California nonprofit public benefit corporate law. This discussion also includes examples and other information in response to the CCWG's questions that may be of interest to the CCWG. The below discussion is not exhaustive and does not provide a description of all mechanisms conceivably available under California law. The analysis has been limited to the questions presented and does not address all issues that may arise in connection therewith. After discussion with the CCWG, refinements and further responses may be warranted.

Our review is ongoing, and if additional questions are presented or proposals submitted, the analysis set forth below may change.

1. Is it possible to have a mechanism that will empower the community to approve ICANN's annual budget and strategic plan?

Mechanisms can be created to provide the community with significant influence over ICANN's annual budget and strategic planning. ICANN currently publishes draft annual budgets and strategic plans for community input and consultation purposes, and regularly holds sessions at ICANN meetings to inform the community, as well as seek the community's input and feedback, regarding these matters.

From a legal perspective, the issue becomes more challenging when the question is whether a mechanism can empower the community to *affirmatively approve* the annual budget and strategic plan such that community approval would be a requirement or condition to the Board's approval of the annual budget or strategic plan. That is, if the community has not approved the budget or plan, then the Board's approval of such matters would not be effective.

As a starting point, California law requires that the activities and affairs of ICANN must be conducted and all corporate powers must be exercised by or under the direction of the Board. The Board may delegate the management of the activities of ICANN to any person or persons, management company or committee however composed, provided that the activities and affairs of ICANN are managed and all corporate powers are exercised under the ultimate direction of the Board. A director must perform the duties of a director in good faith, in a manner that the director believes to be in the best interests of ICANN and with such care as an ordinarily prudent person in a like position would use under similar circumstances. As a result, under ICANN's current structure, the Board must retain the ultimate decision making authority over whether to approve the annual budget or strategic plan.

That said, within ICANN's current structure, there are a number of ways that the community could have input on ICANN's annual budget and strategic plan in addition to the processes that are currently in place.

1. The Board could adopt a Board policy that states that it is the policy of the Board to not approve an annual budget or strategic plan unless the budget or plan has community support. As is the case with other procedures discussed herein, it would be critical to clearly define what constitutes “community support” in order for this policy to be manageable and effective. For example, the Board policy could provide that if a super-majority of each of the Supporting Organizations recommends that the Board not approve the annual budget or strategic plan in its then current form, then the Board would not approve the matter in that form. As a practical matter, the policy would need to enable the Board to continue to direct Staff in the absence of an approved budget or strategic plan until such time that a budget or strategic plan is approved by the Board in accordance with the policy (i.e. the community supports the matter) in order to continue daily operations and avoid such operations being suspended or reduced. Although this would only be a Board policy, the Board would be unlikely to revise it in a manner that would lessen the Board’s accountability due to the context in which it was adopted. Additionally, the Board policy itself could be drafted to require that a super-majority of the Board would need to vote in favor of the modification.
2. Another potential structure to allow the community to have enhanced input on the budget process could be for the Board to appoint a new committee that includes community members for the purposes of reviewing and coordinating the annual budget creation process. This committee could consist of members of the Finance Committee of the Board as well as other financially qualified and interested members of the community. While a committee whose membership includes non-Board members may not act with the authority of the Board under California law, this new committee could be intimately involved in the budgetary process and ultimately make a recommendation to the Board regarding any annual budget submitted by Staff for approval by the Board. The resolutions creating and appointing the budget committee could provide that, among other things: (i) Staff (including the CFO) must consult directly with the committee, (ii) the committee would be provided sufficient time and information to analyze any draft budget (although this could be challenging given a normal budget cycle), and (iii) the Board would seek the recommendation of the committee prior to approving/disapproving any proposed annual budget. The “Board policy” elements of item 1 above could also potentially be worked into the budget committee structure as well, such that it would be the policy of the Board to not approve a budget that has been rejected by the budget committee.

If a more structured approach is desired by the community, ICANN could take even more sweeping steps and modify its current corporate structure to facilitate the oversight sought by the question. In this regard, ICANN could create memberships and amend the Articles to require the members to approve the budget and strategic plan, as well as other specified matters. Alternatively, if the community determined that ICANN should modify its current corporate structure in a less dramatic manner, ICANN’s Bylaws could provide for the appointment of “delegates” under California law (although they can be named something other than “delegates” if so desired). These delegates could have some or all of the authority of

members. Similar to as discussed above, the Bylaws could provide that the Board's adoption of the annual budget and strategic plan be subject to the approval of the delegates. Where delegates are provided for, the Bylaws must set forth the delegates' terms of office, any reasonable method for delegates' selection and removal, and any reasonable method for calling, noticing and holding meetings of delegates. The Bylaws also may set forth the manner in which delegates may act by written ballot.

It is important to note that, even in the context of members and delegates, California law provides that the activities and affairs of ICANN still must be conducted and all corporate powers must be exercised by or under the direction of the Board. Accordingly, members and delegates cannot force the Board to take a certain action or overturn a Board decision. The rights of members and delegates under California law are limited and are more closely associated with approval rights over specified actions, rather than the right to second guess or supersede Board action or inaction. For example, members would only be entitled to approve the Board's budget and would not be able to propose or approve a separate budget. As with any new structure, adding "members" or "delegates" raises a considerable number of governance issues, including the mechanisms to hold these new members or delegates accountable, how these members/delegates would be selected (and how could they be changed), what specified matters would the members/delegates be entitled to approve, what would be the applicable voting threshold for each specified matter, how often would member/delegate meetings be held and how much notice would be required for those meetings, and how would the creation of members/delegates affect the existing Board selection structure. Further, any new structure must be evaluated against the question of whether the new structure actually solves the underlying problem or meets the underlying goal. In some respects, the introduction of "members" or "delegates," while initially appealing, may not solve the underlying problems and could simply result in moving the "problems" to another body of individuals where similar accountability concerns would persist (i.e., who watches the watchers).

2. Is it possible to have a mechanism that will empower the community to have the ability to recommend or approve changes to the Bylaws and Articles of Incorporation?

Yes. Nothing prevents members of the community (including Supporting Organizations and Advisory Committees) from recommending changes to the Bylaws. No changes are needed to the Bylaws or ICANN's current structure in this regard.

If a more formal process to allow the community to have more input on amendments to the Bylaws or Articles was desired, it could be accomplished by adding a provision to the Articles or Bylaws that requires an amendment to a particular provision of such document (and any amendment or repeal of that amendment) to be approved in writing by a specified person or persons (or members or delegates) other than the Board. If the community finds an approval right attractive, careful attention must be paid to the structure of any such approval mechanism. In addition, approvals rights of this nature are typically reserved for significant items.

3. Is it possible to have a mechanism that will empower the community to overturn or require reconsideration of decisions of the Board that were contrary to the Bylaws?

There already exists a legal mechanism available to the community to seek redress if the community believes that the Board is acting contrary to its purpose or the Bylaws. That mechanism is to contact the California Attorney General, which has jurisdiction over ICANN as a California nonprofit public benefit corporation.

Otherwise, applicable California law does not provide for a mechanism that would empower the community, irrespective of whether ICANN has members or not, to overturn the decisions of the Board. The activities and affairs of ICANN must be managed and all corporate powers must be exercised under the ultimate direction of the Board. The traditional corporate remedy for addressing stakeholders' dissatisfaction with board performance is replacing the offending board members, which is discussed more fully in Question 6 below. While extraordinary structures may have varying levels of appeal, many of these structures are built upon the foundation of dissatisfaction with the Board's performance. As a result, these structures often treat the symptoms of the disease and not the disease itself. In the corporate world, the board of directors is responsible for the direction of a corporation and ultimately accountable to its constituents. ICANN is no different.

As it relates to reconsideration, ICANN has voluntarily created a reconsideration request mechanism, but such reconsideration requests are heard by the Board Governance Committee, which has been delegated the authority by the Board to make a final determination and recommendation on the matter. It is possible to revise the existing reconsideration mechanism if certain aspects of the existing mechanism are considered problematic or broken, but the reconsideration process must remain a tool for the Board to obtain outside review of its actions, not a method for an outside party to overturn the Board's decisions. The same considerations could be applied to the Independent Review Process.

Though overturning a decision may not be a possible outcome of a revised accountability process, there is a possibility that review mechanisms could be developed that result in a binding requirement on ICANN to re-do a process that led to a decision that the community did not support.

It is also important to remember that a board of directors, unlike shareholders or members, has a duty to affirmatively act and cannot refuse to act when so doing would breach their fiduciary duties. In addition, an important goal of effective board governance is avoiding deadlock or other paralysis. This is one reason why it is important to have a governance system that allows decisions to be made by or on behalf of those who hold fiduciary duties to the entity.

4. In the case of inaction by the Board on an issue developed through community consensus, is it possible to have a mechanism that will empower the community to require the Board to take action?

No. California law does not provide for a mechanism that would empower the community, regardless of whether ICANN has members or not, to force the Board to take action on a community proposal. The activities and affairs of ICANN must be managed and all corporate powers must be exercised under the ultimate direction of the Board. However, the Board must act in the best interests of ICANN and, if taking an action recommended by the community is in the best interests of ICANN, the Board's fiduciary obligations would compel it to take that action. In this respect, it is important to remember that a board of directors, unlike shareholders or members, has a duty to affirmatively act and cannot refuse to act when so doing would breach its fiduciary duties. As discussed above, the traditional corporate remedy for a board of directors not doing what its constituents wanted would be to replace the offending directors.

5. Is it possible to have a mechanism that will empower the community to prevent ICANN from acting outside its mission?

Again, there already exists a mechanism available to the community to seek redress if the community believes that the Board is acting contrary to its purpose or the Bylaws. That mechanism is to contact the California Attorney General. California nonprofit public benefit corporations are subject at all times to examination by the California Attorney General to ascertain the condition of their affairs and to what extent, if at all, that they have failed to comply with trusts that they have assumed or whether they have departed from the purposes for which they were formed. In case of any such failure or departure, the California Attorney General may institute legal proceedings to correct the noncompliance or departure.

Another option that the community could explore is conditional advanced resignations. Any director may resign effective upon giving written notice to the chairman of the Board, the president or the secretary or the Board, unless the notice specifies a later time for the effectiveness of such resignation. A common corporate practice (albeit in a different context) is to have directors pre-tender their resignations when standing for re-election conditioned on the director not receiving majority support of the stockholders (rather than the plurality that is often sufficient for statutory purposes). If the director does not receive majority support, the Board usually can elect whether to accept or reject the resignation based on their fiduciary duties. It is possible that ICANN could implement a resignation policy with respect to some other metric whereby directors would pre-tender their resignations if they fail to abide by the Bylaws. From a practical perspective, the "event" that would trigger the resignation must be clear and discernible. Additionally, unlike the traditional corporate resignation policy where only the individual director must resign, any sort of ICANN resignation policy would need to consider the practicalities of an event that triggers a large portion, or all, of the Board to resign at once. A mass resignation could limit ICANN's ability to function effectively as a corporation. The benefits of maintaining staggered Board terms is another item to keep in mind, such as the protections against capture.

Finally, it is possible that pockets of the ICANN community could seek the removal of a director that is acting outside ICANN's mission. See the answer to question 6 below.

6. Is it possible to have a mechanism that will empower the community to dismiss one or all members of the Board?

Yes. California law enables a person or entity that designates a person to serve on a board of directors of a nonprofit public benefit corporation to remove that person from office. Accordingly, ICANN's Bylaws could be amended to provide, for example, that the Nominating Committee could remove one or more of its designees from serving as a director of ICANN. While the threat of removal may provide directors with a constant reminder that he or she is accountable for his or her actions, a director serving with the constant threat of removal may be unduly pressured by the applicable constituency to act for the benefit of that constituency and not ICANN or the community as a whole, and in some cases, may result in a director refraining from taking action at all because doing so could result in her removal from the Board. Additionally, it is possible that some otherwise qualified individuals would avoid serving on the Board to avoid being put in such a predicament. Nevertheless, allowing designators to remove their designees under specified circumstances, and allowing for a situation where a majority or all directors could be removed by their designators at the same time if community sentiment was unified, would serve as a significant accountability mechanism.

An alternative approach would be to either eliminate or modify the existing staggered terms provided for in ICANN's Bylaws. The Bylaws currently provide that directors serve staggered three year terms. California law provides that the director terms need not be uniform. Accordingly, ICANN could provide that all directors are elected on an annual basis. This practice is often favored by corporate governance proponents because it holds directors accountable on an annual basis. While this has some appeal, the complexity of ICANN's work and the length of the community's review and decision making processes may require more continuity at the Board level than afforded by an annual election cycle. However, the community could explore a structure that combines the benefits of annual elections while retaining the benefits of three year terms. For example, ICANN's Bylaws could provide for a one year term of office for the directors designated by the Nominating Committee and three year terms for all other designated directors.