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CWG: Legal Scoping Document Preliminary Responses

Draft: March 23, 2015

Qualifications

- *On March 18, 2015, Sidley Austin LLP provided a set of preliminary responses to questions posed by CWG that have arisen as the CWG has worked to develop proposals for the transition of NTIA's oversight of the IANA functions. We have received a supplemental set of questions related to proposals for a "hybrid/integrated model." We are in the process of responding to this second set of questions.*
- *These slides summarize the information we provided in our response to CWG's first set of questions, but we have reordered the information along the lines of the proposals that we understand CWG is considering. To aid in the discussion, we have also included information regarding the hybrid/integrated model.*
- *Please note that, as with our preliminary responses, these slides summarize technical legal information in a generalized form in keeping with the general level of the questions posed. This information is provided for the benefit of the CWG, to help facilitate its consideration of the transition proposals that have been described to us, and should not be relied upon by any other persons or for any other purpose.*
- *These slides reflect, in summary form, Sidley's preliminary independent reactions regarding the questions posed by CWG, and have not been reviewed by any third parties.*

Proposed Structures

- External Solutions
 - Contract Co.
 - Trust
- Internal Solutions
 - Governance solution (e.g., Golden Bylaw, Special Committee)
 - Trust
- Hybrid/Integrated Model
 - IANA subsidiary (“affiliate”) of ICANN
 - IANA shared services agreements
 - Standalone IANA entity

Considerations & Context

- In considering the proposed options, it is important to keep in mind that as a general matter corporate law – including the corporate law of California – is fairly flexible in the design options it provides to organize a for-profit or non-profit entity and to establish the rights and responsibilities as between key participants.
 - In light of this flexibility, as CWG assesses the proposals, primary focus should be on whether the proposals accomplish CWG’s agreed goals and appropriately reflect the rankings of those goals rather than on the legal structure.

Considerations & Context

(CONT'D)

- One example of the flexible nature of potential structures under California non-profit law relates to the potential organization of the multi-stakeholder body itself.
 - For some of the proposed options, a key consideration may be whether and, if so, how to organize the multi-stakeholder community as a legally cognizable entity to provide it with rights and responsibilities in keeping with the accountability goals. For example:
 - to organize as the member body of a non-profit corporation or as an unincorporated association, or
 - not to organize in any formal way and find other means for members of the multi-stakeholder community to be involved in governance, for example by nominating and/or designating or electing directors to a Board of Contract Co. or Board of a new IANA entity.

Structuring of Potential Contract Co.

- Contract Co. could be organized as a California public benefit corporation; other potential options include an unincorporated association, but there are significant disadvantages to the latter structure.
- California public benefit corporations:
 - May be organized with or without members
 - Would be governed by articles filed with the Secretary of State of California and bylaws
 - Amendments to governing documents:
 - Articles require approval of board and members (if any) to amend
 - Bylaws may be amended by the board (subject to certain matters that require member approval) or the members (if any), or exclusively by the members
 - Amendments to articles and bylaws could also require approval of a third party. This third party could be the MRT or some other group. This could function as a so-called “golden bylaw.”

Structuring of Potential Contract Co.

(CONT'D)

- Contract Co. could be “bare bones” with a board and officers but no employees. Third party contractors could be engaged on an as needed basis
- Preventing Contract Co. from capture or acquisition
 - If there are members, membership could be designed to ensure a balance of multi-stakeholder representation
 - Board composition could reflect diversity of interests and geographies
 - Board could be classified (or staggered), with only one-third of directors being elected each year to a three year term (but three year term may make it more difficult to hold individual directors accountable, as compared to annual re-elections where directors can be easily replaced; of course removal options can also be considered)

Structuring of Potential Contract Co.

(CONT'D)

- Protective provisions could be included in the Contract Co.'s bylaws, and amendments to those provisions could require approval of a third party (such as the MRT)
- If there are members, a member could bring suit against the board for breaching its fiduciary duty, or to enforce the “mission” of Contract Co.
- Liability of directors, officers and agents of Contract Co.
 - Individuals serving as directors, officers or agents of Contract Co. could be protected from liability through exculpatory provisions in the articles, as well as insurance and indemnification agreements
 - Exceptions apply in cases of conflicts of interest, such as self-dealing.

Can the MRT be an Unincorporated Entity?

- The MRT should have some legally cognizable form if it wishes to have legally cognizable rights and the ability to sue
- The MRT could be a California unincorporated association
 - Unincorporated associations have limited corporate formalities and do not need to file their governance documents with the Secretary of State of California
 - Unincorporated associations are governed by principles of contract law and statute
 - In California, an unincorporated association can enter into contracts and generally can sue and be sued
 - Directors, members and agents of an unincorporated association are not liable for contractual obligations, except under certain limited circumstances

Can the MRT be an Unincorporated Entity?

(CONT'D)

- The disadvantages of being organized as an unincorporated association include:
 - Lack of a clear standard of care for directors
 - Unsettled law in California on tort liability for members, directors and officers
 - Reluctance of courts in California to intervene in internal disputes
 - A number of non-U.S. jurisdictions do not recognize as legal entity

How Can the MRT Exercise an Oversight Role?

- MRT as Members
 - The MRT could be the members (or sole member, if MRT forms an entity and operates through that entity) of a non-profit corporation or an unincorporated association that contracts with ICANN (i.e., members of Contract Co.)
 - As the members (or member) of Contract Co., MRT would have the power to elect the Board; they could also have approval rights over certain key matters, e.g., removal of Board members, which is a primary means of enforcing accountability, amendments to governance documents, and the transfer of all or substantially all the assets

How Can the MRT Exercise an Oversight Role? *(CONT'D)*

- MRT as Board
 - MRT could be the Board of Contract Co.
 - MRT could be the Board of a newly created subsidiary of ICANN, if the IANA functions is placed into a subsidiary of ICANN, as in the integrated model
- MRT as Committee of the Board
 - The MRT could be a committee to which the Board delegates certain responsibilities
 - However, ultimate decision making would reside with the Board
- The MRT could be an independent third party with approval rights in a non-profit corporation over changes to articles and bylaws

Can the MRT Override Decisions of the Board of a Contract Co.?

- Unless specific authority is provided to a person or entity in the articles and bylaws, and except as its discretion may otherwise be limited through the company's contractual arrangements, a Board has broad discretion to manage and direct the affairs of the corporation in line with the mission described in the articles.
 - The Board bears ultimate responsibility – and often liability – for corporate decisions
 - The Board may generally delegate authority to others, but must provide oversight of the exercise of any powers that it delegates
 - The Board member are fiduciaries and owe duties of care, loyalty and in a non-profit, obedience to the mission expressed in the articles

Can the MRT override decisions of the Board of a Contract Co.? (CONT'D)

- However, the MRT could exercise authority:
 - By itself being the Board of Contract Co.
 - By being the member(s) of Contract Co.
 - One of the primary powers of members is the power to elect directors
 - Members would also have the right to vote on certain matters. These voting rights would be outlined in the articles and bylaws of the corporation, as well as by statute
 - The ability to elect or select directors provides an effective means of holding directors – and by extension the board – accountable to the interests of stakeholders. This is particularly true where the board members serve short terms (e.g., one year terms)
 - Members can also exercise a private right of action to enforce the terms of the corporation's articles and bylaws

Can the MRT override decisions of the Board of a Contract Co.? *(CONT'D)*

- As a committee or group to which the Board of Contract Co. delegates duties
- Depending upon how organized, the ultimate authority resides with the Board, although certain powers may be reserved to the members or otherwise delegated

Could ICANN (or Another Entity) Hold The Right to Act as the IANA Functions Operator in Trust?

- Trust overview
 - A trust is a fiduciary relationship with respect to property in which one person (the trustee) holds legal title to the property, subject to an equitable title held by another (the beneficiary); the creator of the trust is called the settlor
 - Is a trust a viable structure?
 - A trust structure is legally feasible as a method for ICANN or another entity to hold the right to act as the IANA Functions Operator [*internal solution*]
 - A trust could also replace Contract Co. as the party contracting with the IANA Functions Operator [*external solution*]

Could ICANN (or Another Entity) Hold The Right to Act as the IANA Functions Operator in Trust?

(CONT'D)

- In the trust context, the primary difference between the external and internal solutions is the identity of the trustee
 - In the external solution, there is a Board of Trustees comprised of members of the multistakeholder community
 - In the internal solution, the trustee is ICANN, with appropriate accountability mechanisms, such as a trust protector's authority to "regulate" the trustee
- A trust cannot be created without trust property
 - The right to act as the IANA Functions Operator should be a cognizable property right (although an argument could be made that the NTIA's right to designate the IANA Functions Operator is not inherently exclusive to the NTIA)
 - The NTIA contract itself (or a new contract replacing that contract) should also be a cognizable property right
 - A California non-profit corporation can act as trustee, so ICANN could hold this right as trustee (as could another entity)

Could ICANN (or Another Entity) Hold The Right to Act as the IANA Functions Operator in Trust?

(CONT'D)

- A trust must have one or more beneficiaries
 - Charitable trusts may have indefinite beneficiaries (e.g., a community)
 - Defining the beneficiaries of a trust is important because it determines to whom fiduciary duties are owed
 - State attorney general has right to enforce in a charitable trust; question as to who enforces outside the U.S.
- Features of a trust:
 - May or may not need to register with a state court (California does not have such a requirement)
 - Is not a recognized legal entity in all jurisdictions (e.g., civil law jurisdictions, as a general matter, subject to exceptions)

Could ICANN (or Another Entity) Hold The Right to Act as the IANA Functions Operator in Trust?

(CONT'D)

- May enter into a contract and sue or be sued
 - May have a Board of Trustees; it would not have to be incorporated
- Trustee has liability in the event of willful misconduct, but can otherwise be indemnified

Could ICANN, or Another Entity, Hold The Right to Act as the IANA Functions Operator in Trust?

(CONT'D)

- Is a trust "Guardian" recognized under California law?
 - Some U.S. jurisdictions have concept of trust protector: one or more persons or entities are given limited authority to engage in specified actions, such as the power to remove and replace the trustee
 - California does not have a trust protector statute, but trust protectors are employed in California trust
 - MRT could exercise oversight as a trust protector

Community Organization Structure

- Could the functions of Contract Co. be undertaken by an Internet Community Association?
 - An ICA could be organized as an unincorporated association
 - As noted above, it would have the power to enter into contracts and to sue and be sued. Other advantages or disadvantages of an unincorporated association are discussed above as well.
- The ICA as an unincorporated association could be a party to an MOU, but note that an MOU is generally a non-binding (and therefore not enforceable) agreement of terms, rather than a contract. It could also be a party to a contract, which would be binding and enforceable by its beneficiaries.
- The ICA would not be any less of a legal target than a Contract Co.

Hybrid/Integrated Model

Note that these are summary responses. Answers to the specific supplemental questions to follow.

- Structural Considerations
 - IANA staff from ICANN and IANA administrator functions would be organized into a separate legally recognizable entity (PTI)
 - PTI as unincorporated association
 - Would have greater flexibility and less formality in how it is organized.
 - But disadvantages of “unincorporated association” necessitates need for members to be non-profit corporation(s)
 - The Community Board could be the “Board of Directors” of PTI, even if ICANN is the sole member

Hybrid/Integrated Model

(CONT'D)

- Accountability and Independence
 - PTI as a true stand-alone entity has the most perceived independence
 - Consider organizing as a non-profit corporation. Most legal protection for the individuals, well-understood fiduciary duties, and the strongest entity for enforcing rights internationally.
 - Added complexity and formality. Necessitates additional organizations and potential layers of governance structure to reflect the interests of the community. Potential for indirect capture one level removed.

Hybrid/Integrated Model

(CONT'D)

- Accountability and Independence (*cont'd*)
 - PTI as an Affiliate, of ICANN and/or policy organizations (ICANN, IETF and RIRs)
 - Could be an unincorporated association if the members are non-profit corporations. Greater flexibility, less statutory formality
 - Could be a contracting party for IANA functions through SSA
 - Community Board could be the Board of Directors of PTI
 - Perceptions of capture may be greater, but practical protections can be established

Other Considerations

- Antitrust
 - *Per se* illegal cartel exists if combination of competitors or potential competitors join together to fix prices, restrict output, rig bids or allocate markets, customers or territories
 - While the registries may be competitors, the purposes of the CSC and MRT are legitimate and pro-competitive
 - CSC and MRT should adopt formal antitrust/competition guidelines and their meetings should be attended by antitrust counsel

Other Considerations

(CONT'D)

- Bankruptcy and financial liability
 - Can bankruptcy of Contract Co. be prevented?
 - Contract Co. would not be subject to involuntary bankruptcy proceedings under U.S. federal law if the entity “is not a moneyed, business or commercial corporation.” If Contract Co. falls within this exclusion, it would not be subject to involuntary bankruptcy proceedings under U.S. federal law
 - Contract Co. could still be subject to involuntary bankruptcy proceedings under state law
 - If a bankruptcy proceeding were initiated, the assets of the entity would be part of the “estate” that may be available to satisfy claims of creditors
 - Can the financial liability of Contract Co. be limited?
 - There is no mechanism to limit the financial liability of Contract Co., other than the operational means which is to ensure that Contract Co. has limited operations and does not take on liabilities it cannot satisfy

Other Considerations

(CONT'D)

- Protection from litigation
 - Any legal entities created in this transition, whether a non-profit corporation, an unincorporated association or a trust cannot be completely protected from litigation. However, individuals can generally be protected provided they are acting in good faith and lawfully through exculpatory provisions, indemnification agreements and/or insurance
- Contractual indemnification
 - One party can indemnify the other for costs of litigation
 - A determination that a contract is invalid is not dispositive of whether an indemnification provision would be enforceable. One would have to look behind it to the reasons why and the culpability of the entity or individuals in that determination.