

**MEMORANDUM**

TO: Cross-Community Working Group on Enhancing ICANN Accountability

FROM: Sidley Austin LLP and Adler & Colvin

RE: Comparison of Board Proposal to CCWG 2nd Draft Proposal

DATE: September 22, 2015

You requested that we analyze from a legal perspective how the ICANN Board Comments on CCWG Accountability Draft Proposal dated September 11, 2015 (Board Proposal) compares to key aspects of the CCWG Second Draft Proposal (CCWG Proposal). This memorandum provides an overview of our observations. We also provide two attachments that provide additional detail:

Comparison of CCWG 2nd Draft Proposal (Community Mechanism as Sole Member

Model) and ICANN Board Proposal (MEM) (Comparison)

Summary Comparison of Key Characteristics of CMSM Model and Board Proposal

(Summary Comparison)

Please note that our observations are based on the Board Proposal as well as on two discussions that we have had with Jones Day and ICANN Legal. We also provided a draft of the Comparison to Jones Day and ICANN Legal to provide an opportunity for their review to identify any areas where we may have misunderstood the Board Proposal in any material respect.

**Executive Summary: Overview of Key Differences**

The Board Proposal states that the Board would prefer to avoid the degree of change in corporate governance required to convert ICANN to a membership corporation, while stating that it supports the community powers in the CCWG Proposal (although the Board Proposal read in full makes clear that the Board **supports the community powers sought by the CCWG in a less robust form).**

From a legal perspective, the change to a membership corporation simply involves amending the Bylaws**. (ICANN’s current Articles of Incorporation contain express provision for transition to a membership organization.)** There are no requirements to re- incorporate or to re-file for favorable tax status.

From a governance perspective, the change to a membership organization requires that a very limited set of powers be exercised by the community and these chiefly relate to selecting the board of directors. The community through the ACs and SOs and

(ACTIVE 210150807v.4 ) Nominating Committee have experience selecting directors. They also have considerable experience in consulting with one another and reaching consensus.

The most significant differences between the Board Proposal and the CCWG Proposal relate to three key issues:

Whether to rely on the **creation of a member body** – the Community Mechanism as Sole Member (CMSM or Sole Member) -- as the legal means through which the multistakeholder community would hold the ICANN Board accountable;

**The scope of community powers;** and

**The degree to which those powers are enforceable.**

These issues are inter-related and have been the dominant concerns in CCWG’s deliberations to date, as evidenced by the focus of CCWG discussions, efforts of its working groups, and advice requested of its independent counsel.

In sum, the Board disfavors a governance structure that includes a member body and proposes as an alternative **the adoption of certain community powers** with a **binding arbitration mechanism** (Multistakeholder Enforcement Mechanism or MEM) **that is somewhat similar to the binding IRP in the CCWG Proposal**, with processes to encourage community consultation. However the MEM is only **available for challenges by SOs and ACs acting by consensus through the MEM Issue Group with respect to decisions or actions by the Board that are believed to violate Fundamental Bylaws**. Under the Board Proposal, the MEM process and the binding arbitration it provides **would not be available for concerns about violations of Articles and standard Bylaws. (It appears** that while any individual SO or AC, **by consensus**, could initiate **a petition** process to commence MEM arbitration, followed by notice to the other SOs and ACs, to initiate a MEM proceeding, the agreed number of SOs and/or ACs must each, **by consensus**, supports the initiation of MEM arbitration. The SOs and ACs that wish to pursue MEM arbitration would collectively be known as the MEM Issue Group.) The Board Proposal contemplates an IRP, although **it is unclear at this time the extent to which it would be binding.**

Due to the lack of a **member body** and other aspects of the Board Proposal, ICANN’s multistakeholder community as represented by its ACs and SOs would participate in a more **limited set of community powers**, enforceable through **less robust** and certain means than contemplated by the CCWG Proposal. Thus, the Board Proposal presents a different outcome to the debate -- thought to have been resolved with the selection of the Community Mechanism as Sole Member model -- regarding where on the trust-versus-enforcement continuum enhanced accountability mechanisms should be positioned so as to hold the ICANN Board accountable after the NTIA transitions out of its traditional and historic role.

As discussed at length leading up to the CCWG’s decision to propose the Community Mechanism as Sole Member Model, a Sole Designator Model would provide an alternative that provides fairly robust community powers and enforceability though less than the Sole Member Model. We are preparing at the request of the CCWG a PowerPoint comparison of the Community Mechanism as Sole Member Model, the Sole Designator Model and the Board Proposal. Our initial assessment is that the Board Proposal *--* ***due to lack of the legal rights that can attach to a member and a designator -- is closest to the current status quo*** and would deliver the least robust and enforceable community powers of the three models.

Note that there is also a difference between the Board Proposal and the CCWG Proposal regarding the method the community will follow to exercise community powers. **The CCWG Proposal details voting mechanisms and vote allocations, while the Board Proposal would prefer individual SOs and ACs demonstrating their support or objection to community action by passing resolutions under existing SO/AC procedures.** **We note that the Sole Member’s internal method of decision- making could easily be adapted to those outlined in the Board Proposal to address concerns about voting mechanisms and vote allocations, without disturbing the crucial role the Sole Member**

**plays in Board accountability in the CMSM model.**

**Comment from Kavouss**

**In ICANN Proposal when the adoption of a resolution supporting the change to Fundamental Bylaws from each of the SOs, is mentioned it is indicated**  **and no advice against the changes received from the ACs.**

**However, under para. 38**

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| **38. Decision – (Section 7, paragraph 373-376)** |
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| **ICANN Board Comments** |
| With respect to a decision on exercising a community power, the Board agrees with the process proposed, including the time periods set out. However, the Board does not support the need for a Community Mechanism as a centralized place where the multistakeholder participants  are to vote on a decision, nor the need for a Sole Member to act upon the decision. Instead, the Board recommends that the threshold to  exercise a community power be set based upon the existing SO and AC structures. For example, a decision to exercise the community power could require at least two SOs to support exercising the community power, **and no more than one AC providing advice against exercising the community power.** Comment See part 9 (**no advice against the changes received from any of the ACs)** |

**Summary Observations**

**1. Community Powers**

With respect to community powers, areas of specific differences between the Board Proposal and the CCWG Proposal relate to:

**a. Approve Changes to ICANN “Fundamental” Bylaws (Section 4.5)**

Both the Board Proposal and the CCWG Proposal acknowledge that the community should have rights to participate in the process by which changes to Fundamental Bylaws are adopted; they differ on the procedures for doing so. It is unclear how meaningful these differences are.

Under the CCWG Proposal, the Board and the community, represented by the SOs and ACs participating in the Sole Member, would both need to approve changes to Fundamental Bylaws with a high voting threshold. Under the Board Proposal, as explained to us, the Board would commit in the Bylaws not to amend Fundamental Bylaws

unless a specific level of community support had been demonstrated for the change.

It appears that the MEM process would be available to challenge a failure by the Board to follow this procedure.

Note that the CWG-Stewardship final transition proposal requires that the ICANN multistakeholder community have the ability to exercise oversight with respect to the ability to approve amendments to Fundamental Bylaws.

**Comment from Kavouss**

**In the Board s Matrix it is indicated that instead of a vote within the Community Mechanism, the threshold could be a resolution from each of the SOs approving the Fundamental Bylaws change, and no advice against the changes received from any of the ACs. The escalation mechanism in the event the Board failed to follow the Fundamental Bylaws change process would include reconsideration as appropriate and binding MEM arbitration, with recourse to court for enforcement**

**b. Reconsider/Reject ICANN Budget or Strategy/Operating Plans (Section 7.1)**

Under the CCWG Proposal, after an appropriate community process participating SOs and ACs could direct the Sole Member to veto budgets or strategic/operating plans, sending them back to the Board **an unlimited number of times** to develop an alternative acceptable to the community. The Board Proposal provides instead for a community consultation requirement **similar to the current GAC consultation requirement**.( **The process would be similar to situations where the Board has determined that it needs to act inconsistently with GAC Advice☺** The community could force the Board to reconsider and consult twice. Thereafter, the Board could approve a budget or plan over community objections, so long as that budget did not represent an increase of more than 10% over the prior year’s budget, and did not include new substantial line items not accepted by the community. (We note that this assumes the community generally seeks to limit rather than push for greater expenditures.)

As a legal matter, there is a level of uncertainty arising to doubt that Bylaw provisions providing these rights to the community as represented by the SOs and ACs would be legally cognizable, let alone enforceable, outside of a member context.

The CCWG considered at length how the community powers would fit with the Board’s appropriate exercise of its fiduciary duties. In this consideration, a key benefit of the Sole Member model is that California law clearly permits all of the desired community powers, including the proposed veto rights over the budget and strategic/operating plans, to be reserved to the Sole Member, thus avoiding any conflict with the Board’s exercise of its fiduciary duties. The Board Proposal does not address how this issue will be resolved.

o For example, if the Board adopted a budget over community objection with an increase of more than 10%, in violation of the terms of the Bylaws, **and asserted in a court challenge that the Board believed that this was necessary to fulfill its fiduciary duties, there is risk that a court would side with the Board**, since a bylaw that would have the effect of requiring the directors to act without regard for their fiduciary duties could be invalidated in court.

o **Note that concern about conflicts with Board fiduciary duties is the very reason why these community powers would not be subject to binding arbitration under the Board Proposal.** **Thus, the community would lack any meaningful enforcement mechanism for these powers.**

The Sole Member model allows the community to have the ability to reject the budget or strategic/operating plans (and also to address the IANA function separation and review issue discussed below) without creating a conflict between community powers and director fiduciary duties, *and* without creating an enforceability vacuum.

**We note that the CCWG rejected an empowered designator approach because it could not provide enforceable community powers with respect to budget and strategy/operating plan veto for the very same reasons discussed above in relation to the Board Proposal.**

As noted below, the MEM process would not be available to challenge a failure by the

Board to follow this procedure.

**Note that the CWG-Stewardship final transition proposal provides that the community powers with respect to the ICANN and IANA Budgets are key dependencies.** The CWG- Stewardship has acknowledged in its public comment that the community’s ability to veto the ICANN and IANA Budgets separately will meet the CWG-Stewardship requirements, and has stated that “[w]e believe that the CCWG-Accountability draft proposal on budgets is both necessary and sufficient to adequately satisfy these requirements of the CWG- Stewardship final transition proposal.” **c. Reconsider/Reject Changes to ICANN “Standard” Bylaws (and Enforcement) (Section 7.2)**

CCWG has proposed that the community through the CMSM have veto rights for changes to standard Bylaws, e.g., Bylaws that are not specifically designated as “fundamental.”

Like the CCWG Proposal, under the Board Proposal the community would have the opportunity to object to proposed standard Bylaws amendments. **SOs and ACs could demonstrate their objections by passing resolutions within current SO/AC structures and processes, and the Board would commit in the Bylaws not to amend the Bylaws over community objection above a specified threshold.**

It is unclear whether binding arbitration would be available to challenge a failure by the Board to follow procedure regarding community objection to proposed standard Bylaw amendments. **If these provisions for community input into changes to standard Bylaws were embedded in Fundamental Bylaws, then it appears that the MEM process would be available.**

**However, it is clear that the MEM would not be available to enforce Board compliance with standard Bylaws**, **since under the Board Proposal, binding arbitration would not be available to seek redress of violations of Bylaws not designated as “fundamental.”**

Note that in the CCWG Proposal, the distinction between standard Bylaws and Fundamental Bylaws is that Fundamental Bylaws are those determined to be so important that the community should be involved in approving any change. By providing that only Fundamental Bylaws are enforceable through the MEM, the Board Proposal equates those Bylaws that the community seeks to approve changes of with those Bylaws for which community enforcement is available. **However, the Board is obligated by law to abide by *all* Bylaws (whether standard or Fundamental), and therefore an enforcement scheme that is intentionally designed to enforce just one type of Bylaws raises concerns about the potential for important accountability gaps.** Such a differential approach to Bylaw enforcement should be subject to rigorous stress testing. **We note also that the MEM does not appear to be available to enforce compliance with the Articles of Incorporation,** which under law have even more force than Bylaws. There may be an accountability gap if there is not a robust binding IRP or other binding arbitration process available to enforce the Articles.

Comment from Kavouss

Agreed that the standard of review requires modification. As an initial step, the Board recommends rolling back the standard of review to the standard that was in place pre-April 2013, stating: “Requests for such independent review **shall be referred to an Independent Review Panel (IRP) which shall be charged with comparing contested actions of the Board to the Articles of Incorporation and Bylaws**, and with declaring whether the Board has acted consistently with the provisions of those Articles of Incorporation and Bylaws.” Additionally, the Board proposes continuing consideration of the standard of review in the IRP enhancement work that will be ongoing.

**d. Appoint and Remove Individual ICANN Directors (Section 7.3)**

Instead of giving certain SOs and ACs the right (effectuated through the Sole Member) to unilaterally remove the directors they appoint, under the Board Proposal**, removal of individual directors would be available only for narrowly defined causes and only upon community consensus as represented by the SOs and ACs** (although the appointing SO or AC could initiate community consideration of removal). It appears that grounds for removal would be limited to:

o Serious violations of governance standards, including statutory causes for removal

(fraud);

o Refusal to abide by the processes set forth to enable new community empowerment areas; and

o Failure to abide by the outcome of a MEM process.

A petition process is envisioned by the Board Proposal for removal, but it is unclear whether the SOs and ACs determine the final outcome including whether the standards set forth above have been met. Directors would be required to provide standing letters of resignation, to be triggered after opportunity for the director to be heard and a community consensus process.

Since the Bylaws would not provide for a Sole Member (or any other form of membership) and the Bylaws would not provide ACs and SOs with express designator rights cognizable under California law, there is potential that the process would need to rely on the Board for implementation, albeit with possibility of recourse to binding arbitration through the MEM if the dispute is found to qualify. In the CCWG Proposal, the decisions of the Sole

Member are under the direction of SOs and ACs. Once the Sole Member acts (and it can only act as directed), director selection and removal are effectuated. If the Board resisted in any way, the Sole Member, again acting as directed by the consensus of SOs and ACs, could go directly to court for declaratory relief regarding the composition of the Board.

Because the Board Proposal does not change the existing processes for selecting directors, it does not clarify whether some or all the SOs and ACs and other stakeholders that select directors (directly or through the Nominating Committee) are “designators” with the rights of designators provided under California law. (Note that there is legal uncertainty as to whether or not ACs and SOs currently have a legal right to select directors sufficient that California law would deem them to be designators with automatic rights to remove the directors they have selected with or without cause.) Designators have the right to remove the directors they select without cause. Without revision to make a clear choice among the governance options that are available under the corporate law, both the current regime and the Board Proposal present uncertainty and are therefore vulnerable to potentially destabilizing challenges going forward.

It is unclear whether binding arbitration would be available to challenge a failure by the Board to follow the appointment and removal procedure. If the provisions for appointment and removal of directors were embedded in Fundamental Bylaws, then it appears that the MEM process would be available.

**Note that the CWG-Stewardship final transition proposal requires that the ICANN multistakeholder community have the ability to appoint and remove members of the ICANN Board.**

**Comments from Kavouss**

The Board suggests the development **of pre-service letters to be signed as a condition of serving on the ICANN Board**. These letters would indicate **cause f**or removal from the Board upon the occurrence of specific events, including:

**e. Recall of Entire Board (Section 7.4)**

**Unlike the carefully designed process in the CCWG Proposal to permit the Sole Member upon a high level of community consensus to recall the entire Board, the Board Proposal does not address full Board recall as a separate concept. Under the Board Proposal, a recall of the full Board is essentially the simultaneous individual removal of all thedirectors (other than the President). While it appears that the community could effect the removal of the full Board by following the process for the simultaneous recall of all directors, the same level of consensus would apply for removing a single director.**

**Note that adopting a single standard for both situations runs the risk that the standard for removing an individual may be too high and the same standard as applied to removing the full Board may be too low. Moreover, the limitations on reasons for removal would continue to apply.**

It is unclear whether binding arbitration would be available to challenge a failure by the Board to follow the appointment and removal procedure. **If the provisions for appointment and removal of directors were embedded in Fundamental Bylaws, then it appears that the MEM process would be available.**

**Note that the CWG-Stewardship final transition proposal requires that the ICANN multistakeholder community have the ability to recall the entire ICANN Board.**

**f. Reconsider/Reject Board Decisions Relating to Reviews of the IANA Functions, Including Ability to Trigger a Separation of PTI (Section 6, Paragraph 300)**

Note that the CWG-Stewardship final transition proposal requires that the ICANN multistakeholder community have the ability to exercise oversight with respect to key ICANN Board decisions (including with respect to the ICANN Board’s oversight of the IANA functions) by reviewing and approving:

o ICANN Board decisions with respect to recommendations resulting from an IANA Function Review (IFR) or Special IFR; and

o ICANN Board decisions with respect to the ICANN and IANA Budgets (discussed in subsection (b), above).

Under the same analysis provided in subsection (b), above, absent a member model there **is a level of uncertainty arising to doubt that Bylaw provisions providing these rights to the community as represented by the SOs and ACs would be enforceable outside of a member context.**

**As noted above, the MEM process would not be available to challenge a failure by the Board to follow these procedures.**

**2. Community Enforcement Mechanism**

The CCWG Proposal would use the IRP process and allow it to render binding and enforceable decisions in the form of binding arbitration with respect to disputes regarding violations of ICANN’s Articles of Incorporation and Bylaws (both standard and Fundamental Bylaws). While individual ACs and SOs could access the IRP process, decisions to go to court to institute enforcement of binding arbitration decisions would be made by community consensus through the CMSM.**The Board Proposal recommends creating the separate MEM process (in addition to an IRP process that may or may not be binding) for use by the community in seeking review of actions that are alleged by the ACs and SOs to be in violation of the Fundamental Bylaws** **(but not Articles or standard Bylaws).** To the extent that community powers are included in Fundamental Bylaws, the MEM would be available for enforcement of community powers. However, as detailed above it is clear under the Board Proposal that some community powers will not be subject to MEM binding arbitration.

**Comments from Kavouss**

**The legal Team is kindly requested to clearly defince which community power will not be subject to MEM binding arbitration.**

The MEM proposed by the Board is similar to the IRP process proposed by CCWG, although the CCWG IRP would be available for a broader set of issues given that it is not limited to enforcement of Fundamental Bylaws.

o Both proposals contemplate that after the failure of internal reconsideration escalation procedures, an arbitration process could be invoked to produce a decision that could be enforced in court if necessary.

o Both the CCWG’s proposed binding IRP and the MEM process would result in a binding arbitration award, which could be enforced in court.

Under the Board Proposal, the Sole Member would not be available to either support or enforce community powers or IRP decisions. In addition to the concerns described above regarding conflict with fiduciary duties of directors for certain community powers outside a member context, there are two components to the Sole Member role in enforcement that the Board Proposal must address absent the Sole Member concept:

o ***Capacity* as a legal person to seek enforcement in the courts; and**

**o *Standing* to enforce Bylaws.**

The Board Proposal addresses capacity to sue by proposing that SOs and ACs collectively form a MEM Issue Group. **If formed as an unincorporated association under California state law it would have the capacity to sue as a legal person.** (The Board Proposal also suggests that the necessary legal personhood could be achieved by individual SOs and ACs becoming legal persons or the community forming some other legal person, or the chairs of the SOs and ACs acting as individuals to enforce binding arbitration decisions in court.) In the CMSM model, the CMSM would be a legal person with the ability to enforce rights.

Standing to sue will presumably be addressed by setting forth in Bylaws an express right of ACs and SOs through a MEM Issue Group to enforce the Bylaws.

Note that legal counsel for ICANN and for CCWG have not identified any significant legal disagreements regarding the requirements of standing and capacity to sue (legal personhood) for enforcement of binding arbitration awards.

**3. Community Decision-making for Exercise of Powers**

The Board Proposal voices concern that the CMSM model’s reliance on a voting mechanism could undermine the consensus decision-making model the Board notes is the current norm within ICANN (although we understand that at least some SOs and ACs come to decisions based on majority vote from time to time).

o “The Board does not support the need for a Community Mechanism as a centralized place where the multistakeholder participants are to vote on a decision, nor the need for a Sole Member to act upon the decision.”

o “**The Board recommends that the threshold to exercise a community power be set based on the existing SO and AC structures. For example, a decision to exercise the community power could require at least two SOs to support exercising the power, and no more than one AC providing advice against exercising the power**.”

o The Board Proposal favors having existing SOs and ACs pass resolutions to register their consent or objection regarding the exercise of decision rights, supported by a Bylaw that would require the Board to act or refrain from acting if a specified threshold number of SOs or ACs are in agreement. (It is unclear how much this differs from the concept generally of “voting”.)

There is nothing about the Sole Member’s internal structure that requires use of a voting mechanism; governance and decision-making within a California unincorporated association is extremely flexible. The Sole Member’s internal voting process could be replaced with the same approach to community decisions as in the Board Proposal. This would provide the community with the same powers, and the same level of enforceability, as the CCWG Proposal.

Comments from Kavouss

In view of the Board, s proposal that voting be replaced by Consensus with no no advice from an AC against or with no more than one advice against that consensus it is doubtful that the two proposals could replace each other ?

Additional clarification of the similarities, and the intent of any material differences, between the CCWG and Board proposals with respect to community decision-making may be beneficial in determining whether agreement could be readily achieved.

o For example, the CCWG Proposal sets out both a consultation and a voting procedure for directing the actions of the Sole Member. The voting procedure may be perceived by some, including the Board, to reflect a move away from the ICANN community’s tradition of, commitment to and experience with consensus- based decision making. While the CCWG Proposal emphasizes that there is no intent to change how SOs and ACs reach internal consensus, the CCWG may wish to consider whether there is a need to clarify that the community’s consensus- making processes are not intended to be changes and that the “voting” mechanism was meant to provide a means of assessing the level of consensus. **The Board Proposal seeks a consultative consensus based approach, rather than voting, based on use of existing AC and SO procedures.**

* **The Board does not specify what level of agreement between the SOs and ACs is necessary to constitute a consensus** for community action, and we understand that the Board generally would defer to CCWG to determine the appropriate threshold(s) that may apply to particular actions. (For example, should the Sole Member model survive, it is contemplated that a very high degree of consensus would be necessary to exercise certain statutory powers).
* **Comment from Kavouss**
* It is not clear what the Legal Team meant by a very high degree of consensus would be necessary to exercise certain statutory powers
* Consensus means no formal disagreement in pronounced. If the legal team intended to associate an adjective to the term consensus such as soft or hum consensus, it is difficult to legally validate that intention .