



One Firm Worldwide<sup>SM</sup>

## MEMORANDUM

**TO:** ICANN

**FROM:** Jones Day

**DATE:** 19 October 2015

**RE:** Response to CCWG Counsel Memo of 12 October 2015 related to Board Member Fiduciary Duties

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In the Sidley/Adler (“CCWG Counsel”) memorandum of 12 October 2015, CCWG Counsel states that California corporate law does not permit a Board to agree in advance to “arbitrate its core fiduciary duties.” As a result, it has been advanced that, under a single designator model, “the scope of available arbitration is limited by the Board’s fiduciary duty, which cannot be arbitrated.” We believe CCWG Counsel’s advice has largely been taken out of context, and is being used in ways that are not supported in law.

It has been suggested that, under a designator model, arbitration is not available if the Board asserts a “fiduciary duty” defense (i.e., where the Board refuses to follow a given community power because, in the Board’s view, it would require the Board to violate its fiduciary duties). However, according to CCWG Counsel, if there is a member, and there are powers reserved to that member, then Board actions that relate to those reserved powers (such as budget) can proceed to arbitration. It is not correct to draw such a distinction.

All decisions of the ICANN Board are to be made consistent with the Board members’ fiduciary duties. This is not unique to ICANN. Any decision the Board takes, whether on proceeding with a new program, electing to contract with an entity, acting on an individual gTLD application, or adopting a budget and strategic plan, must be taken in accordance with fiduciary obligations. In each instance, each member of the Board is required to exercise his or her fiduciary duties as he or she votes to proceed on any particular matter consistent with ICANN’s mission. The existence of the fiduciary duties that each Board member is required to adhere to in making each decision is not debated, and no proposal discussed thus far proposes to arbitrate the existence of these “core fiduciary duties.”

The question to be determined in the proposed binding arbitration is whether the Board’s decision or action violated ICANN’s Bylaws or Articles of Incorporation. *Each* of the decisions of the Board can be referred to arbitration pursuant to the terms of new Bylaws that ICANN might enact to implement the transition proposals. The fact that each decision of the Board was made consistent with and thus involves “core fiduciary duties” does not make those decisions

any less arbitrable. For example, the Board might decide to enter into a new registry agreement with a “controversial” gTLD applicant; that decision certainly requires the members of the Board to exercise their fiduciary duties, but the decision then could be the subject of binding arbitration in which the arbitration panel would determine whether the Board’s decision violated ICANN’s Bylaws or whether the Board violated its fiduciary obligations in reaching that decision. That arbitration decision could then be turned into a court judgment, which would be absolutely enforceable as against the Board.

Even where the act of the Board that was being challenged was the adoption of a budget, or the strategic plan in violation of procedures set forth in the Bylaws, for example, those decisions could still be challenged in an arbitration proceeding. The question for arbitration would not be whether the Board had a duty (or not) to pass the budget or strategic plan (i.e., did the duty exist), but instead whether the Board violated the Bylaws or Articles of Incorporation in adopting the budget or plan in the way it did. This is a wholly appropriate topic for arbitration, regardless of the model selected.

Furthermore, the enforceability of an arbitration award concerning a decision made by the Board, which necessarily involves the exercise of the Board’s fiduciary duties in reaching that decision, cannot be doubted. Today, the ICANN Board enters into contracts with registries and registrars, the Board then makes decisions that can be subject to arbitration, and there is no question that those arbitration awards would be enforceable, notwithstanding that the members of the Board were required to exercise their fiduciary duties in taking the decisions at issue. Likewise, any decision involving the types of issues that the CCWG has been addressing could be arbitrated, and an arbitration award related to that decision would be enforceable with no caveats.<sup>1</sup>

In short, depending on the facts and claims involved, a court almost certainly would enforce a binding arbitration award notwithstanding the fact that ICANN may assert that compliance might force it to breach the perceived fiduciary duties of certain Board members.

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<sup>1</sup> Indeed, even assuming ICANN persuaded a court that compliance with a binding arbitration award would force the Board to breach its fiduciary duties, such a holding would not necessarily lead the Court to find that the binding arbitration award is unenforceable. Asserting a “fiduciary duty” defense is somewhat like arguing that compliance with the community power would constitute an illegal act by the Board. The California Supreme Court has recognized in analogous circumstances that where “the denial of relief would be disproportionately harsh in relation to the gravity of the [illegality asserted]”, the plaintiff should not be denied relief. *Asdourian v. Araj*, 38 Cal. 3d 276, 294 (1985). The arbitration claimant would need to show that it would suffer severe injury were the award not enforced, but that hurdle should not prove insurmountable. Indeed, where “no serious moral turpitude is involved . . . and defendant would be unjustly enriched at the expense of plaintiff,” a court would likely find in favor of the arbitration claimant. *See Southfield v. Barrett*, 13 Cal. App. 3d 290, 294 (1970).