

## MEMORANDUM

**TO:** CCWG Legal Sub-team

**FROM:** Gregory L. Colvin, Rosemary E. Fei, Stephanie L. Petit, and Steven R. Chiodini

**DATE:** March 27, 2015

**RE:** Preliminary Response to Legal Sub-team Questions Identified in Request CCWG/AC/001

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At the outset, please understand that we have been engaged in this matter for less than a week, and we still have many hundreds of pages of existing governance documents and records of proceeding to review. Consequently, the following responses reflect our immediate reactions to the questions posed, as informed by our experience with solving similar problems under California nonprofit corporate law. As we digest the extensive background reading on the matters that were addressed recently in Istanbul, and as we discuss our analysis with you in the coming days and weeks, we expect to refine and elaborate on our answers below, and we may be able to propose additional alternative structures and methods. Also, please note that given the limited timeframe, we have not been able to explore exhaustively all the nuances of your questions or all the potential consequences of models we propose. Accordingly, we may determine with further review and research that new mechanisms or models need to be considered in order to meet CCWG's goals.

- 1. Which available legal mechanisms would provide the means for achieving the CCWG's above-stated goals and concerns and how would we do it? Examples to evaluate: different corporate legal structures, amendments to bylaws or articles of incorporation, creation of internal or external decisional review mechanisms, legal contracts, community "veto" process, designators, etc. What additional legal (or legally viable) mechanisms are available to achieve the above-stated goals and concerns?*

Our discussion here will begin with the broadest view of nonprofit corporate architecture under California law. While our immediate response will not address all the points you raise in your question, it will provide a general framework for locating rights, powers, duties, and functions between the ICANN community and the organization's leadership.

Ultimately, we believe an optimal design will identify the parties responsible for making the final decision on a variety of issues, while at the same time ensuring that those decisions are the product of a fair process that preserves the integrity of the organization's commitments.

**Statutory members.** Under California nonprofit corporate law, a corporation may have members, who by law have the right to vote for directors, to nominate candidates for the board, to inspect lists of all other members, to sue the directors and officers to enforce charitable trust on behalf of the corporation, and to receive due process prior to being terminated, suspended, or expelled. (In this context, when we use the term "members," we are referring only to statutory members with a role in governance as defined in the California Nonprofit Public Benefit Corporation Law, although of course the word can be used colloquially in many other ways.) In terms of considering structural options, it is important to note that members may be individuals, or may be legal entities, either existing or to be established for this purpose. Unlike directors, members may vote in person (or through a representative of the member organization) or by proxy. Also unlike directors, members have virtually no fiduciary duties imposed on them by the corporate law. In addition to the statutory rights given to members by California law, the bylaws can provide for extraordinary powers of approval and veto, which in the context of ICANN's multi-stakeholder community might include the requirement of supermajority member approval to a bylaws amendment modifying language from the Affirmation of Commitments, or special veto power over a budget adopted by the Board (which would otherwise not be within the purview of members). However, action by the members to intervene in the business management of the corporation could conflict with the Board's fiduciary duty to manage such affairs in the best interests of the corporation. While we are not yet clear that a governance structure with statutory members is appropriate for ICANN, we do believe that this option merits further exploration.

Finally, it is important to recall that for a statutory member to be terminated, California law requires a due process hearing in which the member can respond to charges before being terminated by the Board or other disciplinary body. You may regard this right as a positive or negative attribute of membership, but choosing to have statutory members will require the organization to either have an internal judicial procedure to handle expulsions, or understand that initial members will be quite difficult to terminate.

**Self-perpetuating board.** Most California nonprofit corporations use the simplest form of governance, which is the self-perpetuating board of directors, where the directors in office elect their successors or re-elect themselves. Obviously, such a closely-held arrangement is not appropriate for ICANN, in light of what we have learned about the organization and its diverse stakeholders.

**Designation.** We think that the option, specifically provided by the California Nonprofit Corporations Law, to have some or all of the board of directors appointed or "designated" by persons or entities outside of the board, is also worth examining further.

Designators not only can place directors on the board, but can remove and replace them, and be given the right to approve some or all changes to the articles or bylaws. Because designators lack fiduciary duties, they can accomplish these functions without fear of legal repercussions arising from the corporate law. Designators do not have the rights and protections afforded members by statute. Where elements of the statutory framework for voting members are incompatible with CCWG's goals, this may be an advantage over a membership structure. Moreover, to some extent the absence of statutory protections can be compensated for with careful drafting of bylaws and/or contracts with designators.

We could design a governance architecture based on the ultimate designation powers held by a constellation comprised of ICANN's multi-stakeholder community. We have, for instance, organized "designator councils" in which a group of designators decide collectively to fill one or more seats on the board. Thus, you could organize ICANN's multi-stakeholder community into a series of designator circles that appoint members of ICANN's Board. Those designators could be individuals, but more likely they would be legal entities, such as existing organizations or "light" unincorporated associations assembled solely for the purpose of exercising designation powers.

Some or all directors could be chosen by certain designators. Alternatively, nominations could be derived from designators grouped by common interests, with the final selection of directors made collectively at-large, with all designators participating. While the Bylaws would clarify that they are "designators," they could be labeled and known as stakeholders, constituents, or any other desired name.

**Board as ultimate authority.** Designators ordinarily function only to appoint and remove directors and sometimes to approve changes to the articles and bylaws. It would be unusual (but we believe it may be possible) to assign policy or quasi-judicial functions to them, or a subset of them. Note that the central principle of public benefit corporate law in California and many other places is that the ultimate authority to make corporate decisions and be legally responsible for them rests with the board of directors and cannot be usurped by or transferred to anyone else.

**Recourse of constituents.** If the constituents of a nonprofit corporation, whether they be voting legal members or designators, are not happy with the actions of the board on policy, budget, or other matters, their ultimate recourse is to replace some or all of the directors, thereby installing a board that is more in tune with the will of the constituency. This power can be exercised summarily or deliberatively, quickly or slowly, depending on the design of the governance. Often the threat of replacement is enough to force the board to change the course of its errant decisions.

**Two board tiers possible.** A board can be structured with an upper and lower tier of authority to exercise corporate decision-making powers. Namely, there can be a very large board that may have over a hundred directors, at the same time as the powers and

functions ordinarily exercised by a board of directors itself are delegated to a far smaller executive committee of a dozen or so who are also members of the large board.

The large board would meet in session at least annually and more frequently if a crisis required it to be convened. Certain powers are reserved to the full board by California corporate law (such as appointments to certain committees, removal of directors, certain bylaw amendments), and others may be reserved under the bylaws (budget approval, legislative policy stances). All other functions, however, may be delegated to the executive committee, which can be fully empowered to manage the affairs of the organization. At the same time, the full board would always have the power to step in and overturn any decision of the executive committee.

While every member of the larger board would have the fiduciary duties of a director, directors have extensive legal protections, including the business judgment rule, the ability to rely on legal counsel and other experts, statutory immunities, indemnification, and so forth. Most importantly, California law entitles directors who do not serve on a committee of the board to rely on that committee in discharging their fiduciary duties, essentially off-loading their fiduciary duties to the committee members, provided the committee is properly established and appointed and the reliance is not unwarranted in the circumstances. Moreover, the corporation should consider purchasing directors' and officers' insurance as well, if consistent with ICANN principles.

Apart from the structure of a much larger board with a smaller, more active executive committee, it would be quite difficult under California nonprofit public benefit corporate law for a managing board of directors to have its decisions overturned by a higher authority, since California corporate law (and, indeed, the corporate law in other U.S. jurisdictions) posits the board of directors as the ultimate oversight authority in the corporation. (Our response to Question 6 poses some other approaches to achieve this goal.) While members or designators can elect and replace directors, and may have the power to make or amend a decision that is imbedded in the bylaws, their powers to intervene in management should be limited, because they do not take legal responsibility for the corporation's business decisions.

**Summary of one possible structure.** To review, one kind of governance architecture we might imagine for ICANN to be accountable to its multi-stakeholder community might have the following characteristics, with the superior authority on top:

- Multi-stakeholder constituency (designators organized in councils as unincorporated associations), able to appoint and remove directors.
- A very large Board of Directors, ultimately authorized to make and be responsible for corporate decisions, accountable to the community.

- An Executive Committee, a subset of directors that closely supervises management of the organization, operating with authority delegated by the Board and accountable to the Board and generally fulfilling the role that would ordinarily be performed by a board of directors in a similar corporation.
- Other Board Committees, with delegated authority for special assignments (audit, investment, compensation, etc.), accountable to the larger Board.
- Officers, as authorized by the Board to sign contracts, make expenditures, etc., on behalf of the organization, accountable to the Executive Committee and to the Board.
- Employed staff, who are hired, fired, supervised by and accountable to officers.
- Contractual arrangements to supplement corporate law relationships, as needed and possible.

It is also possible to blend all three mechanisms for installing directors on the Board. One or more seats could be filled by **statutory members** having the most powerful bundle of rights under California law, while the rest are filled by weighted appointment votes taken among various **designator councils**. The bylaws could even provide for the **Board itself** to elect one or more individuals to the Board due to their special expertise or other value to the corporation, or to allow them to serve as the Executive Committee directors.

2. *What are the benefits, responsibilities, and risks including but not limited to the legal and financial liability of board directors, statutory members, representative delegates, and community participants (both collectively and individually) for ICANN's actions (including debts, bankruptcy, etc.) under the different legal structures available under California nonprofit corporations law?*

**Board directors.** A director who acts in good faith in what that director believes to be the best interests of the corporation, and as an ordinarily prudent person under like circumstances would (discussed in question 5 below), should not have any personal financial liability for debts of the corporation, in bankruptcy or otherwise. Of course, such a director could still be sued, even if the suit is ultimately unsuccessful, and a suit can be difficult and expensive. Because of this, the corporate law permits (and in some circumstances even requires) indemnification of legal expenses for directors sued. Insurance can also be purchased to help cover certain costs. While there are certain protections for volunteers under both federal and California law, in our experience, they have limited practical value, because they can be easily circumvented by appropriate pleading in a lawsuit.

**Statutory members and designators.** Under California nonprofit corporate law, statutory members should bear no legal or financial liability for ICANN's actions. (There may be very limited exceptions, such as where the member owes unpaid dues to the

corporation.) Similarly, neither designators nor other community participants should bear any legal or financial liability for ICANN's actions by virtue of this status alone.

3. *What are the costs or barriers to participation in ICANN's bottom-up policy development or decision making processes under the different legal structures and mechanisms under consideration for both existing participants and potential participants? How do the different structures and mechanisms under consideration assess against each other with respect to concerns about "capture" or undue influence, costs, barriers to participation, and required time to transition to a new structure?*

Regardless of the structure chosen, whether the supporting organizations or advisory committees making up the community are characterized as corporate members or designators, or whether they are represented on a large "superboard," any bottom-up decision-making process will require three things: (1) defining who is entitled to participate in the process; (2) unless all participants at the bottom level will have equal voting power, defining participants' relative voting power; (3) defining which decisions may or must be subject to the full decision-making process from the bottom level; and (4) determining the proportion of votes required for a making a decision.

**Participants.** Given the culture of ICANN, the following should be transparent: (1) the identity of participants in the bottom-level decision-making process (i.e., a roster of participants must exist, and if participants are groups, possibly a roster of their individual members), (2) what qualifications are required and how new participants may be admitted to that status, and (3) how and when participant status may or must terminate and for what reasons. We understand that currently the existing SOs and ACs and their component subgroups are the participants, as described in ICANN's current bylaws; going forward, do we need to address how this list of participants might change? (For example, would SOs and ACs be able to dissolve? merge? be expelled? resign? Could new SOs and ACs be formed, and would new ones receive the same power as the existing ones?) Would the Board, the whole community, or a special committee, be empowered to admit new participants to the voting regime? If rules exist and are sufficiently robust, we only need to learn what they are and draft them into governing documents.

If they do not exist or are not robust, however, developing these rules may be a politically delicate and time-consuming process, since the role of participants in the community in the future will be more empowered, and therefore presumably more important, than before. Setting qualifications and standards for termination of participant status may present opportunities for reducing the risks of capture and undue influence by factions, and qualifications may present barriers to future participants. If creating minimum qualifications would result in changes to the existing list of participants, the transition may need to be phased in over some period of time, or existing participants could be grandfathered in (i.e., exempt from new requirements). If the community were comfortable, in the interests of time, we could

also defer addressing any changes to the participant list, and draft governing documents that assume the current list is static.

We would also need to consider to what extent to address the individual membership and internal decision-making process within the SOs and ACs in ICANN's governing documents. If each of the SOs and ACs were structured as an unincorporated association and member of ICANN, for example, ICANN's bylaws would not need to address their internal processes at all.

This part of the legal work will be approximately the same regardless of whether the participants are characterized as members or designators or represented on a superboard, depending on the structure chosen.

**Voting power.** We understand that the community has discussed whether different participants should have different voting power relative to others. While equal voting power for all participants would be simpler, differential voting power can be accommodated in any of the structures under consideration. In a membership structure, for example, each group of participants with the same voting power would be a class of members; multiple classes of members are permitted, with different voting rights and power. In a designator structure, some designators could be given more seats on a governing board and more votes in other decisions made at the designator level. Or designators could be consolidated into affinity groups, where each circle of designators names a director. With a superboard, there would be more seats available for the representation of more participants.

**Decisions.** Deciding which decisions may or must be made at the bottom level ("reserved decisions") will require balancing several competing interests. If too many decisions are reserved, the entire process of making decisions may become too cumbersome and slow; individuals may not be motivated to provide volunteer service on the Board if they feel disempowered by constant bottom-level decision-making; too many decisions being made by participants with no fiduciary duty to the overall community may result in outcomes that are not in the community's best interests; more opportunities for bottom-level decision-making may encourage development of factions and alliances; at the extreme, an excessive level of control over ICANN's day-to-day operations might even expose the decision-makers to some liability in lieu of the Board of Directors.

We understand the community has already developed a list of decisions appropriate for bottom-level action, although we have not yet had the opportunity to consider any of them carefully. For each of them, we would need to know whether the community wants exclusive power to initiate a decision (i.e., Board would have no authority), power held jointly with the Board to make a decision (requiring both community and Board to agree), or merely veto power over certain Board decisions. We need more information before we can advise on the workability and risks of a given set of reserved decisions.

Reserved decisions, including decisions to spill the entire governing board, present challenges under California corporate law. While it is accepted practice under California corporate law for some decisions to be reserved to members, there is less authority for giving decision-making powers to designators other than those specified in the law. On the other hand, corporate law is protective of member rights, and it will be difficult under the corporate law to allow for removal of directors on the board who were elected by members by anyone other than those members. Failing a pure corporate law solution, decision-making powers might be conveyed to designators by contract, if the designators are legal entities (i.e., unincorporated associations). We believe some hybrid of corporate law and contract law constructs will allow us to create a structure that will satisfy the goals initially described to us, although we have not yet settled on the best combination.

**Proportion of votes required.** Setting the level of agreement among participants at the right level for each reserved decision is critical to ensuring that agreed arrangements are neither too hard nor too easy to change in the future. Supermajority requirements can also reduce the risks of capture and undue influence. Some reserved decisions will warrant a higher level of agreement to change, although as a matter of organizational governance, we would rarely if ever recommend requiring complete consensus (unanimity) because that gives a single participant extraordinary veto power.

4. *What are the available legal mechanisms for constraining ICANN's activities and preventing the organization from expanding the scope of its mission in the future? How could a contract, "golden bylaw" / "durable bylaw", or some other enforceable agreement achieve this goal? Which available mechanisms provide the most advantage to the community and the most effective means of enforcement?*

There are a number of mechanisms of varying efficacy for restraining ICANN's future leadership from expanding the scope of the organization's mission and undertaking new activities, even where a majority of the community agrees with such expansion.

**Securing against changes in ICANN's governing documents.** If a California nonprofit public benefit corporation has statutory members, the approval of those members would be required for any amendment to the articles of incorporation (except for certain technical amendments not relevant to the present discussion), and for any amendment of the bylaws that materially or adversely affected the rights of members as to voting or transfer. (Where more than one member class exists, any amendment that materially and adversely affects the relative rights of a class requires the approval of that class.) These are the minimal statutory settings. The articles and bylaws can require much higher thresholds for amending these and any other provisions (including, for example, purpose statements), and indeed the bylaws themselves can give sole amendment power over the bylaws to the members.

Even where there are no statutory members, the articles and bylaws can require the approval of specified third parties, such as the designators who appoint directors, to any amendments. In this way, significant power could in principle be given to small groups of



dissenters among the stakeholders to block an attempt by the Board to amend the governing documents to expand the scope of ICANN's mission, even if the attempt had wide support from other stakeholders.

**Requiring outside approval for Board actions.** California's Nonprofit Public Benefit Corporation Law permits bylaws to require the additional consent of statutory members for key actions of the Board, beyond decisions such as mergers and dissolutions that require member approval as a matter of law. For example, the bylaws may require member approval of an annual budget. However, a balance must be struck, as giving members excessive rights to veto regular Board actions raises other concerns: it could render the directors incapable of fulfilling their fiduciary duties, or make board service unattractive, or even potentially expose the members to liabilities from which they would ordinarily be shielded under corporate law.

For non-member third parties such as designators, corporate law provides that they may be given the right to consent to certain or all amendments to the articles of incorporation or bylaws. It should also be possible to give them special approval or veto rights in the bylaws over other Board actions, either as a matter of corporate law, or through contractual arrangements. (The concept of designators was incorporated in to California corporate law in 1980, but with minimal statutory framework, and minimal case law development since. Designation of directors is not available in many states.)

A right is only as useful as the holder's ability to enforce it, however, and in this sense a statutory membership structure may have an advantage, since statutory members have legal standing under California's Nonprofit Public Benefit Corporation Law to bring suit derivatively on behalf of the corporation against its leadership for breach of charitable trust or misuse of corporate assets. Such a suit could be used to compel the Board's compliance with ICANN's bylaws by arguing that failure to follow bylaw requirements is such a misuse. The downside with having statutory members is the potential ability of a single dissenting member to ensnarl the Board with litigation, given the members' statutory standing to bring derivative suits for charitable-trust breaches.

With or without members, directors and officers of a California nonprofit corporation also have standing to sue for breaches of bylaws that result in misuse of corporate assets.

As a matter of corporate law, enforcement would present more of a challenge for an outside party such as a designator, which, absent some other status, would not have standing to bring suit for breach of charitable trust if the Board decided to disregard the bylaws in such a case. We believe a more powerful mechanism for the outside party, whether to enforce a right given to it under the bylaws or as a substitute for including a right in the bylaws, would be to create a contract between the outside party and the organization itself that provided perhaps liquidated damages and/or recourse to judicial mandamus actions in a court of law if the Board caused a breach. Also, since the outside party's basis for suit could be tailored in the contract, the potential for disruptive litigation could be controlled better than with statutory members.

### **Other restrictions and enforcement mechanisms.**

*Tax-exempt status.* Aside from matters of corporate law, ICANN is of course a tax-exempt public charity subject to extensive restrictions on its activities under U.S. federal and California tax law. While the need to maintain ICANN's exemption compels it to operate within these strictures and would prevent it from, for example, engaging in an unrelated business as a substantial part of its overall activities, ICANN would still have significant leeway to expand the scope of its charitable mission within the general framework of its exemption. The U.S. Internal Revenue Service is the agency charged with enforcing ICANN's compliance with the requirements of its charitable tax-exempt status, and while it may respond to whistleblower complaints by opening an examination or audit, it retains discretion over what allegations to pursue.

*Charitable trust restrictions.* Under California law, the assets of ICANN are impressed with a charitable trust, one result of which is that the corporation cannot use the contributions it has received and revenue it has earned for purposes broader than those set forth in its articles of incorporation or bylaws (or, with gifts, for purposes beyond those permitted by more restrictive donor instructions at the time of contribution). Although the purposes set forth in the governance documents can be expanded in the future, only assets received *after* this expansion could be deployed for those more expansive purposes. Over time, however, this restriction would likely become less and less onerous, as prior funds are exhausted and newer, less restricted revenue is realized. Also, standing to enforce this charitable trust is limited, as discussed above, and in our response to Question 7 below. Accordingly, if after several years the leadership of ICANN and a substantial portion of the community with governance rights wanted to expand the scope of the organization's mission, there may be little in practice that dissenters could do to stop it, absent a right under ICANN's governing documents to veto such decisions.

*Trust form.* We note that, in the scoping document and elsewhere, there are references to the use of trusts as a way of imposing restrictions on ICANN. This use of the word "trust" must be distinguished from charitable trust restrictions on ICANN's use of its assets discussed above and elsewhere; this sort of trust is a form of legal entity recognized under California law and the laws of the various United States, as well as in other countries. One key characteristic of a trust, both a strength and weakness, is the ability to incorporate terms and restrictions that cannot ever be changed. ICANN is not a trust, and converting it to a trust would not be a trivial undertaking. More importantly, we cannot envisage any term or restriction to be imposed on ICANN where such immutable permanence is appropriate, given the potential for unforeseeable changes in the operating environment in the future. The ability of corporations to evolve to meet changing needs and circumstances seems to us to be an advantage in this situation, even taking into consideration the community's desire for accountability.

5. *What does it mean for an ICANN board member to hold a fiduciary duty to the organization? To what extent can a board member meet her/his legal obligations as a corporate fiduciary while also representing the interests of a particular segment of the community that appointed her/him to the board? How to increase (or even maximize) a director's ability to represent the interests of the community that appointed her/him in the course of board decisions, given legal duties of board members to the corporation? To what extent are ICANN's board members required to approve or reject a community decision regarding the management of ICANN based upon the board's separate and distinct interpretation of "what is in the best interest of ICANN" or "the global public interest"?*

**What is fiduciary duty?** Fiduciary duty in the charitable corporate context is centered on the idea that certain persons are entrusted to make key decisions and act in the best interests of the corporation and the public charitable trust in which the corporation holds its assets, rather than in the person's own interests or the interests of anyone else.

The California Nonprofit Public Benefit Corporation Law explicitly spells out fiduciary duties as follows:

- The Board of Directors as a group is ultimately responsible for overseeing the corporation's affairs. The Board may delegate appropriately and rely on information that officers, employees, expert advisors, and individual directors may provide to it.
- Directors must act in good faith in what they believe to be in the corporation's best interests (known as the "duty of loyalty"), with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under the circumstances (known as the "duty of care"). This standard includes both a *subjective* and an *objective* element. The individual must in good faith believe (*subjective*) s/he is acting in the corporation's best interests. Regardless of his or her belief, s/he must also act in a way that meets or exceeds an *objective* standard—how an ordinarily prudent person in a like position would act under the circumstances.

**What does fiduciary duty mean for an ICANN Board member?** Applying these standards, an ICANN Board member in voting must consider what is best for ICANN and not for him or her personally. Where he or she is selected by a particular constituency to serve on the ICANN Board, his or her fiduciary duty remains to vote in the best interests of ICANN rather than in the best interests of the constituency, if they conflict.

This last observation is particularly relevant for an organization like ICANN, which encompasses multiple stakeholder groups, which can and do have divergent interests and priorities. Fortunately, in ascertaining the best interests of ICANN, an ICANN Board member must consider and take into account whatever s/he genuinely believes is relevant to

the decision, including his or her knowledge of the constituency, how the constituency is likely to react to the decision, and the importance to ICANN of maintaining a good relationship with that constituency and other constituencies, if relevant. In short, an ICANN Board member must vote in what he or she believes to be ICANN's best interests, but those beliefs are necessarily informed and affected by the knowledge he or she has of his or her constituency. An ICANN Board member cannot vote only in the constituency's interests without considering, and giving primary importance to, what is in the best interests of ICANN. A constituency concerned that its Board member vote in its best interests could brief the director as best it can of facts and arguments to influence him or her to make the decision the constituency wants, and to help the director convince others on the Board to do so as well. But if what a constituency wants is clearly and unavoidably bad for ICANN, the director will not be able to vote as the constituency wants without breaching fiduciary duties. Such a situation could also indicate far deeper problems than the director's dilemma; assuming all constituencies are in fact committed to ICANN's overall mission, this problem should not occur.

**To what extent can an ICANN Board member approve or reject a community decision regarding the management of ICANN?** Applying these principles, an ICANN Board member must determine what s/he believes is in ICANN's best interests, and this belief would be informed by the knowledge that the community made a certain decision regarding ICANN's management. For example, one Board member might believe that the community's decision is truly wrong and not in ICANN's best interests and therefore vote another way. Another Board member might believe that the community's decision is problematic, but that s/he should nevertheless vote as the community wishes, because ICANN's acting in a way the community does not desire in this instance would cause political or other problems that outweigh ICANN's acting as the director personally believes it should. That is, determining the best interests of ICANN requires the director to weigh many considerations, including deference to the views of others under certain circumstances.

Note that in most structures, a constituent would have the ability to remove or recall the director it elected. The typical recourse for the constituent in a situation where its selected director does not act as the constituent wishes is to replace the director with someone the constituent believes is more likely to vote and act as it wishes.

6. *How could the board be bound to accept decisions made by an Independent Review Panel (or other independent entity) including decisions pertaining to the Board's oversight of the management of the organization?*

Ordinarily, the board of directors of a California nonprofit public benefit corporation is its highest governing authority. Its members have fiduciary duties to the corporation, to act with due care and in the corporation's best interest. Any failure to fulfill those duties that results in harm to the corporation exposes the director to personal liability to make the corporation whole. As a matter of good corporate governance, the board's ultimate control as a governing body, acting through the collective decisions of the individual directors,

demands the accountability provided by these fiduciary duties. Neither members nor designators owe the corporation any fiduciary duties; there is nothing in corporate law to prevent them from making any decisions given to them purely in their personal interests, whether selecting directors to serve on the board, or any other reserved decision. The normal mechanism for controlling a board is for members and/or designators who appointed or elected specific directors to be able to remove them at will if their decisions are not satisfactory; in a corporation without members, the board itself is given this same power over each of its members.

Nonetheless, there are at least four legal mechanisms or arrangements under which a board of directors could be required to accept decisions made by an independent panel or entity. We are not yet in a position to say which of them might best meet the community's needs. Indeed, we may develop other mechanisms for binding a board to implement a third-party decision as we continue to consider possible structures in light of the community's priorities and goals.

1. If the members of the panel were the members of the corporation, choosing all the directors, or if the entity were the sole corporate member, the member(s) could remove and replace the board if it refused to implement the decision. Alternatively, if the decision were within the members' reserved powers with member initiation authority, the member(s) could simply make the decision in lieu of the board. (On its face, this doesn't appear to fit well with structures, but the concept that members have the right to remove directors and exercise reserve powers could have a role in addressing this issue.)
2. If the members of the panel were in fact the board of directors, and the so-called "board" was in fact a subordinate executive committee of the true board, then the true full board would have the corporate law authority to overrule the committee "board." This is essentially one version of the superboard approach.
3. If, as a condition of becoming a director, each director signed a contract with the corporation, agreeing that the director would resign if he/she were unable or unwilling to implement a decision by the panel or specified entity, then directors who opposed the decision would be deemed to have resigned. This approach could be bolstered by having a resignation attached to the contract that specified it would become effective upon the demonstrated inability or unwillingness of the director to implement the decision, signed by the director at the time of joining the board. The resignations would be held by the corporation until the conditions for effectiveness occurred, if ever.

4. If the corporation entered into a contract with a third party that required the corporation to implement the decision of the panel or specified entity, and provided for a severe penalty for breach of contract, then (absent some truly extraordinary circumstance, such as where the decision would involve the corporation in criminal conduct) it would clearly be in the best interests of the corporation not to breach that contract and incur the penalty. Accordingly, the directors, who have a fiduciary duty to act in the corporation's best interests, would either have to implement the decision, resign, or breach their fiduciary duty, exposing the director to personal liability to the corporation to make it whole for the penalty the corporation would have to pay the third party for its breach of contract.
  
7. *How could the California Attorney General (or other public official) intervene in ICANN's operation on behalf of community members? How typical is such an intervention by the California Attorney General in the operation of a nonprofit corporation, what are the grounds for such intervention, and what is a reasonable expectation for a successful remedy in this situation?*

**Role of California Attorney General in regulating charities.** California's Attorney General regulates charities incorporated in California and other charities that do business in California and solicit donations from California residents. The Attorney General's role is to protect charities and their beneficiaries, and to protect charitable assets from being misspent. Misspending of charitable funds of course includes theft or fraud, but also includes using assets given for one charitable cause for another purpose, whether charitable or not.

**Attorney General authority to intervene in charities.** The Attorney General has broad authority to intervene in corporate affairs of a California nonprofit public benefit corporation. For example, she may bring suit to remove a director (or may intervene in such an action brought by another, such as a member) in cases of a director's alleged fraud, dishonest acts, gross abuse of authority or discretion, or breach of a fiduciary duty. As other examples, the Attorney General may bring or intervene in an action to appoint a provisional director where the board is deadlocked and can no longer function, and where a transaction involving a material financial interest of a director is alleged to have been unfair or unreasonable to the corporation. For many major transactions (merger, transfer of substantially all assets, dissolution), notice to the Attorney General or her consent is required. Very commonly, the Attorney General will examine organizations where charitable funds have been alleged to have been misspent, and may sue to recover such funds.

**When is the Attorney General most likely to intervene?** In our experience, it is rare for the Attorney General to involve herself in a charity's internal governance unless misuse or misspending of substantial charitable assets is alleged. More commonly, if the Attorney General receives a viable complaint about a charity involving the misspending of significant charitable assets, she may examine the charity, including the corporate governance mechanisms that allowed the alleged misspending to occur. We have seen the Attorney

General require changes in a charity's processes and corporate governance to correct what she believes were problems that allowed misspending.

For the Attorney General to intervene upon the complaint of a community member, the community member would probably have to claim that ICANN assets were being squandered. Examples of such waste could include: officers took a vacation using ICANN funds; ICANN paid above fair market value for goods or services, perhaps by entering into an inappropriate contract with an insider; ICANN used donations outside the purposes in ICANN's governing documents or accepted the donations for a very specific purpose, and spent them on a different purpose than agreed, even if the different purpose was otherwise a permissible activity for ICANN. Given ICANN's high profile and the importance of its work, however, it is conceivable the Attorney General might use her broader authority where she would not otherwise.

**Conclusion.** While the Attorney General has broad authority to regulate charities in California, most typically, her interest focuses not on corporate governance itself but rather on assuring that charitable assets are spent properly (which of course may implicate corporate governance). Therefore, unless the Attorney General treats ICANN differently from most other California charities, her office will likely not provide a significant source of enforcement to the governance issues ICANN is considering. However, as discussed in response to Question 9 below, ICANN's directors, members, and officers are in a position to sue ICANN, for even a very small diversion of charitable assets, such as where a procedure required by the bylaws has not been followed by the Board. Their individual willingness to sue, and their access to the resources to do so, may undermine reliance on them as a mechanism for accountability, but in our view, they are more likely to act than the Attorney General, unless the alleged violation involves misuse of significant charitable trust assets.

8. *How to best incorporate certain aspects of ICANN's Affirmation of Commitments into the organization's corporate governance structure (possibly its bylaws) and also to provide for the effective enforcement of those commitments?*

As a general matter, we typically advise against including extended statements of mission and community commitment in bylaws, which in our experience function more efficiently when they are limited to specific matters of operational governance, such as establishing the procedures for electing directors, holding board meetings, appointing committees, and so forth. We understand, however, that ICANN has made various public pronouncements, including the statement by its CEO, Mr. Chehadé, in the February 25 hearing of the U.S. Senate Committee on Commerce, Science, and Transportation, on enshrining the Affirmation of Commitments in the bylaws. Also, in ICANN's specific case, we believe that there may be real value in having certain parts of the Affirmation of Commitments incorporated into the bylaws. (Although we have reviewed the discussion and materials from the March 24 morning session on this matter, we have not yet had the opportunity to go through the Affirmation of Commitments in detail and identify which aspects could readily be copied into the bylaws.)

We think the primary enforcement benefit to having this language in the bylaws is political rather than legal. First, placing the Affirmation of Commitments in the bylaws, the central governance document, secures for them a place of primary importance in the life of the organization going forward. Second, certain parties with standing under the California Nonprofit Public Benefit Corporation Law (such as directors, officers, or members acting in a derivative capacity on behalf of the corporation—for reasons explained above, the Attorney General is far less likely to act) may be able to successfully sue for an injunction against the board to compel compliance with the bylaws as a matter of charitable trust. A suit on this basis might be difficult to argue and costly to bring, and any eventual injunction may have little practical effect, but the public consequences could be significant if the media reported that the ICANN Board of Directors was being sued for noncompliance with the bylaws. (For this reason, we recommend that you consider incorporating the affirmed Commitments into the bylaws as obligations of the Board of Directors, rather than of the ICANN corporation itself.)

9. *What is recommended for an interim mechanism/caretaker board arrangements if the entirety of the Board of Directors are spilled by the community?*

The key issue here is that there should at all times be people in governance positions at ICANN who owe fiduciary duties as a matter of law to the organization. There are a number of ways this issue could be addressed during the interim period between the removal of the entire Board and the re-selection of a new Board:

- Officers of ICANN owe fiduciary duties to the organization under the California Nonprofit Public Benefit Corporation Law. Accordingly, the bylaws could provide that if the entire Board is removed and no directors remain, officers *who are not ordinarily directors under the Bylaws* would govern the organization as interim directors *ex officio* until new directors were appointed or elected. This approach could be risky, however, if the officers come from specific stakeholder groups or constituencies, or some are executive staff members, since putting them into power as an interim Board would give their natural loyalties an outsized degree of influence over the organization.
- The bylaws could provide for a “shadow” panel of pre-selected individuals who would automatically take office as directors during the interim period. While this approach would help to avoid the risk of giving undue influence to specific groups, since the members of the panel could be selected specifically for diversity, there may be several practical difficulties, including the need for maintaining an up-to-date list of members for this shadow panel during times when no one is focused on the prospect of this “nuclear option.”

In either of the above scenarios, the bylaws could contain emergency provisions that require special approval thresholds (e.g., supermajority votes of the interim Board or special member approval for actions that could ordinarily be taken at the Board level) in order



to prevent the interim Board from doing more than maintaining the organization in stasis until the new full Board is elected.

The above considerations would become moot if, as we suggest in a previous response, the “board” is legally an executive committee charged with managing the day-to-day affairs of the organization, while the actual legal Board is a much larger group of stakeholder representatives. In that case, the larger Board could remove the members of the executive committee at will (California law would require a threshold vote of at least a majority of the directors then in office). With the executive committee “board” removed in this way, oversight of ICANN’s day-to-day affairs would revert to the large stakeholder group that constitutes the legal Board and that owes fiduciary duties to the organization as a matter of law.

We understand that the possibility of “spilling” the entire Board is perceived as an essential ultimate accountability mechanism to ensure community control over it, in particular as a way for important segments of the community to reset ICANN’s governance as a last resort if they lose confidence in the way the current Board is operating. While the concept of removing the entire board at once is something we have rarely encountered in our California practice, and California corporate law is not as amenable to this option as the laws of other (particularly non-U.S.) jurisdictions may be, it should be possible to structure this sort of remedy into the bylaws and to provide for an adequate transition mechanism, as we have discussed above. That said, we would strongly recommend considering whether a wholesale removal of the Board would accomplish the intended objective, and whether less extreme solutions may prove more effective. For example, if a membership structure is chosen, the members could retain the best directors while removing those in whom they have lost confidence, thereby preserving continuity of governance while addressing the problem that triggered the action. Also, many of our client organizations serving broad communities have adopted board structures that facilitate frequent turnover of directors and an annual succession of officers through the highest positions. In this way, an organization is able to prevent one block on the board from becoming stuck in a position of authority or obstinacy; leadership is continually renewed, with recently elected directors and officers bringing a fresh perspective onto the board, and the organization having the continuous chance to educate new groups of directors about their responsibilities as leaders.

10. *Would it be possible under California law for the community to limit the direct or other damages of third parties (ex: gTLD applicants) in a lawsuit against ICANN and if so, how? Are there ways to create disincentives to filing frivolous legal claims against ICANN? How could such limitations be created so there is little “wiggle room” in contract negotiations for ICANN, for example through boilerplate contract clauses?*

We realize that the threat of frivolous lawsuits is often a reason to avoid contacts with the United States. While there are various volunteer protection laws available at the federal level and in some states, as discussed above, these are generally insufficient to prevent lawsuits where the complainant hires a skillful attorney. Unfortunately, for an

organization like ICANN with a worldwide reach, frivolous legal claims in U.S. courts will be a real and unavoidable phenomenon. This is true regardless of where ICANN is legally domiciled. Moreover, ICANN is subject to the laws of any state in the U.S. where it can be deemed to have sufficient nexus or business contacts, so the laws of California are relevant only to the extent a Californian is the complainant, or the claim arises based on ICANN activities in California. ICANN's state of incorporation will automatically allow suits against ICANN there, but will not preclude suits against ICANN anywhere else. We believe this analysis is also true internationally, although that is well outside our expertise.

While literally anyone who can afford the filing fee can sue anyone else for anything, at least in the United States, it is of course worthwhile to take steps to avoid lawsuits, to allow any such lawsuits to be dealt with summarily in the judicial system, to win any lawsuits that go to trial, and to protect ICANN and its directors, officers, and other agents from the consequences of such lawsuits, whether lost or won. While this is not a matter of bylaws or corporate governance, we would recommend that ICANN review its operations to look for opportunities to reduce the likelihood of lawsuits against directors and officers in the course of its business. Some typical steps we have helped other clients implement include:

- Internal policies designed to reduce the likelihood of harm to third-party interests, such as legally compliant personnel policies for employees, policies on the management of public events, policies on review of published materials for defamation and copyright infringement, policies for material posted on organizational websites, etc. Avoiding harm is always the first line of defense in avoiding a lawsuit. (We note that the employment relationship (wrongful termination, discrimination, harassment, etc.) is by far the most common source of lawsuits against a nonprofit's directors.)
- Requiring tightly drafted waivers of the right to sue and releases of liability wherever applicable. For example, perhaps the gTLD application form could include such a waiver as a condition of considering the application. While certain extreme waivers and releases may be invalidated as against public policy, they are generally favorably viewed by California courts, provided the waiving/releasing party has been adequately informed of the effect of its agreement.
- Appropriate insurance for ICANN's various activities, including general liability, special events coverage, advertising coverage, employment practices, and directors' and officers' insurance. For the latter, it is critical that the insurance include adequate coverage for a director's defense costs prior to resolution of a claim.
- As a matter of contract law (i.e., as opposed to tort law), the threat of frivolous claims can be reduced by including a provision that requires the losing party to pay the legal fees and costs of the prevailing party. While the laws of the fifty

states do vary, and although we do not practice regularly outside California, the fundamental elements of contract law are generally similar across the country, and we believe such clauses are a widely used disincentive to frivolous suits.

- Lastly, we note that the indemnification provision in your current bylaws requires the corporation to indemnify its agents, which includes its directors and officers, to the maximum extent permitted by law. This provision does not, of course, protect ICANN itself, and there are limits to its effectiveness otherwise, but we can advise further on this matter upon request.

The Legal Sub-team may wish to redirect this question to the Sidley Austin firm, given their breadth of experience in commercial law outside of California, and with matters involving litigation, both of which are outside this firm's expertise.