

MEMORANDUM

TO: Legal Sub-team of the Cross-Community Working Group on Enhancing ICANN Accountability

FROM: Sidley Austin LLP and Adler & Colvin

RE: Legal Assessment: Executive Summary, Summary Chart and Revised Governance Chart

DATE: April 23, 2015

Overview

This memorandum provides an executive summary of the information provided in the Memorandum and Governance Chart that we provided to you on April 20, 2015 ([Link](#)), as requested. It also attaches:

- the one-page chart you requested summarizing and comparing the six powers under the four models that have been discussed in our meetings ([Annex A](#), the “[Summary Chart](#)”); and
- a revised Governance Chart, as requested, with conclusions added to the headline of each power ([Annex B](#), the “[Revised Governance Chart](#)”).

Executive Summary

A. Legal Personhood

- In order for any of the six powers to be viable under any model, the persons or entities that seek to invoke and enforce the powers must be “legal persons” (an individual or a legally recognized entity such as a corporation or unincorporated association).
 - o This will require adjustments to the current status of the SOs and ACs that become designators or members. However, structuring SOs and ACs as unincorporated associations should not expose the existing constituents of those bodies to additional liability as compared to the status quo, and indeed forming unincorporated associations may provide a degree of liability protection due to statutory protections afforded unincorporated associations under California law.

B. Director Removal, Board Recall, and Amendment of Bylaws and Articles (Powers 1-4)

- **Viable in Both Designator and Membership Models.** The first four powers identified in the Revised Governance Chart—director removal, board recall and bylaw and article amendments—may be granted to the community in an enforceable manner (“viable”) under either a designator model or a membership model, although the membership model provides a clearer and more straightforward means from a legal perspective.
 - **Board Recall Implementation.** Implementation of the full board recall right will require some additional steps: a contract among the designators or members to coordinate the removal, or a “springing” irrevocable resignation letter required of each director before appointment that would become effective upon a triggering event specified in the resignation (such as a vote of no confidence). These implementation steps are second order issues at this point in the process.

C. Approval, Ability to Block, Reconsideration of Strategic Plan and Budget (Powers 5-6)

- **Viable in Membership Model; Not Viable in Designator Model.** The power to approve, block action or require reconsideration by the board with respect to strategic plans and the budget are treated differently in law from the first four powers discussed above. Corporate law enables members to reserve certain powers and approval rights in the bylaws, including the kind articulated here. Designators *do not* have this statutory right.
 - **Membership Model—Legally Viable.** In a membership model, decisions such as approval of the strategic plan and approval of the budget may clearly be reserved to the members as a matter of statute. This means that if such powers are reserved, a board approved budget and strategic plan will not take effect until also approved by the members.
 - **Designator Model—Not Legally Viable.** The ability to reserve decisions to designators is much less clear, because designators are treated differently from members under corporate law:
 - **No Established Corporate Law Basis.** There is no basis in the corporate statute to reserve these types of decisions to designators.
 - **No Standing.** Designators do not have the ability under corporate law to bring suits against the board for exceeding authority or violating fiduciary duties. (Members have such rights.)
 - ◆ **IRP Limits.** Note also that although the Independent Review Panel (IRP) described in Annexes A and B to our April 20, 2015 memo ([Link](#)) would provide additional ability for the community to challenge certain board decisions and ICANN actions, the IRP process may not be used to take fundamental decision-making from the board with regard to certain key duties that lie at the heart of

fiduciary activity, and this likely extends to matters of budget and strategy.

- **Contractual Solution Not Viable.** While contracts could be created between designators and ICANN to try and bridge this gap, with ICANN agreeing to make the strategic plan or budget subject to approval of the designators, this approach poses the same challenge discussed above with respect to the limits that the IRP process faces. Therefore, there is significant risk that such contractual provisions would not be enforceable because the board cannot, as a matter of corporate law, make its exercise of fiduciary duties subject to approval of a non-member third party.
 - ◆ **Director Liability.** Even if the contracts were enforceable, directors would run a significant risk of breaching their fiduciary duties by entering into these contracts because they would be making core board functions subject to outside approval (or blocking rights). They would also be placed in the difficult position of deciding between breaching a contract and breaching their fiduciary duties (with the latter subjecting directors to personal liability).
 - **Limited Reconsideration Right.** A right lesser than approval or blocking could be implemented in a designator model, namely a right to request reconsideration, provided that the ultimate decision on these matters is reserved to the board and reconsideration cannot be used to block a decision through never-ending reconsideration requests.

D. Bind Board to Implement IANA Function Review Recommendations

- The CWG-Stewardship proposal ([Link](#) to public comment page) specifies that an ICANN board decision to modify or reject the IANA function review recommendations be subject to review and approval of the community, and therefore CCWG should consider this additional power in considering the designator versus member models. As explained above, this power is equivalent to approving the strategic plan or budget, and thus an enforceable approval right can be reserved only to the members, not designators.

E. Single Member Model

- Recently there have been discussions of potentially structuring certain of the SOs and ACs into a single unincorporated association that would serve as the single member of ICANN. While having a single member would facilitate full board recall, there are already effective mechanisms under both the multiple-member and designator models to achieve that result. Furthermore, we believe that rather than solving the accountability issues identified by the community (and overcoming the standing and enforceability issues), a single member model would recreate those issues, but one step removed at the member level. For that reason, we recommend against further consideration of a single-member model.

ANNEX A
SUMMARY CHART

[Attached]

Power	Status Quo (with no change to current governance)	Designator Organized ICANN	Member Organized ICANN	Single Member Organized ICANN
1. Full Board Recall	<p>Not viable¹ under current bylaws</p> <p>The current bylaws result in a structure that is similar to the designator model, but none of these powers have been articulated in the present bylaws.</p> <p>SOs and ACs that are to have these powers must be legal persons (individuals, entities or unincorporated associations). This is a necessary change for all proposed powers, but is not repeated in each cell below.</p>	<p>Viable under bylaws with contract or “springing” resignation that takes effect on vote of no confidence.</p> <p>Designators must be legal persons (individuals, entities or unincorporated associations). This is a necessary change for all proposed powers, but is not repeated in each cell below.</p>	<p>Viable under bylaws with contract or “springing” resignation that takes effect on vote of no confidence.</p> <p>Members must be legal persons (individuals, entities or unincorporated associations). This is a necessary change for all proposed powers, but is not repeated in each cell below.</p>	<p>Same legal viability as the multiple-member model, but NOT advisable because it would add only complexity without contributing any real advantages.</p> <p>With this model, all the same issues about the ability of the community to assert control over the board would remain, as would the issues of coordinating action among the disparate stakeholder groups. The only difference is that this model would insert another corporate layer between the board itself and the community.</p> <p>Single Member must be a legal person, and any community groups that help to select the member must themselves be legal persons in order to enforce their rights.</p>
2. Individual Director Recall	Not viable under current bylaws	Viable under bylaws	Viable under bylaws	Viable under bylaws, but NOT advisable. See above
3. Approve Regular Amendments to the Articles/Bylaws	Not viable under current bylaws	<p>Viable under bylaws.</p> <p>Designators cannot initiate bylaws amendments, only approve or reject board proposed amendments</p>	<p>Viable under bylaws</p> <p>Members can change bylaws without board approval. Board approval required to change articles.</p>	Viable under bylaws, but NOT advisable. See above
4. Approve Changes to Golden Bylaws or Articles	Not viable under current bylaws	Viable under bylaws	Viable under bylaws	Viable under bylaws, but NOT advisable. See above
5. Approve Strategic Plan	<p>Approval not viable;</p> <p>Reconsideration right viable but with limits on how often and not ultimately binding</p>	<p>Approval not viable;</p> <p>Reconsideration right viable but with limits on how often and not ultimately binding</p>	<p>Approval right viable under bylaws;</p> <p>Reconsideration right viable under bylaws</p>	Viable under bylaws, but NOT advisable. See above
6. Approve Budget	<p>Approval not viable;</p> <p>Reconsideration right viable but with limits on how often and not ultimately binding</p>	<p>Approval not viable;</p> <p>Reconsideration right viable but with limits on how often and not ultimately binding</p>	<p>Approval right viable under bylaws;</p> <p>Reconsideration right viable under bylaws</p>	Viable under bylaws, but NOT advisable. See above

¹ Throughout this chart, “viable” is used to mean enforceable through a judicial process (including by enforcement of contracts consistent with the Board’s fiduciary duties).

ANNEX B
REVISED GOVERNANCE CHART

[Attached]

Designator Model

Membership Model

Where can right be created?

How can right be exercised?

How can right be enforced?

Where can right be created?

How can right be exercised?

How can right be enforced?

1. Full Board Recall

Viable under bylaws with contract or “springing” resignation that takes effect on vote of no confidence. To exercise any of the powers proposed in this chart, designators must be legal persons (individuals, entities or unincorporated associations), but this is not repeated for each power below.

Viable under bylaws with contract or “springing” resignation that takes effect on vote of no confidence. To exercise any of the powers proposed in this chart, members must be legal persons (individuals, entities or unincorporated associations), but this is not repeated for each power below.

Right in bylaws and backed by statute: Designator can remove its own designated director(s) at any time for any reason; designator’s approval is required before *board* can remove a designated director *without cause*.

(1) The **bylaws** provide procedures for a board no-confidence vote—e.g., a vote by 2/3 of the designators, or a community vote of some sort. This would be the **triggering event**.

(1) The **contract** among designators is enforced by the designators themselves or by some third-party beneficiary (e.g., ICANN corp.) named in the contract. If one or more designators fail to remove their directors at a triggering event, a suit is brought to compel performance. The forum for resolving the dispute—e.g. arbitration, court, etc.—can be specified in the contract.

Plus a contract among designators is also required, in order to coordinate designator removal action and effect a recall of the entire board.

(2) The **contract** among the designators specifies that, whenever this *triggering event* happens, each designator is required to remove its designated directors on the board.

(2) If the board refuses to acknowledge the designators’ action to remove them **as a matter of corporate law**—e.g., the directors simply ignore the removal and continue to act as the board—the *replacement directors* newly named by the designators bring suit to enforce their own appointment. (It is possible that the designators themselves may be able to bring this sort of suit, but further research is needed.)

(3) Each designator then removes its directors pursuant to its **bylaw/statutory rights**, and the total board is recalled.

Right in bylaws and backed by statute: Each member class [1], and only that member class, can remove its own elected director(s) at any time without cause.

Same mechanism as for designators, if a contract is used to manage the process around full board recall.

Same as for designators with respect to the members’ rights under the inter-member contract.

Plus a contract among member classes (or see General Comment below regarding voting agreements) in order to coordinate member-class removal action and effect a recall of the entire board.

All members would vote together on whether to recall the full board, in a procedure set out in the bylaws. Since each member is its own class, each member can devise its own internal procedures for determining what threshold is required to cast the member vote for full-board removal (or for individual director removal). If the triggering event occurred, that would trigger the contractual obligation for each member (acting as its own member class) to remove its own directors.

In addition, members can bring suit (1) individually for a failure by the board to follow the bylaws and statute in refusing to acknowledge removals or appointments; and (2) on behalf of the corporation against the board where the corporation has suffered harm, and/or there has been a breach of charitable trust as a result of board action or inaction.

Note [1]: In a traditional membership corporation, the members vote to elect the board. In ICANN, each group with power to put directors on the board could be organized as a member in its own member class. In that way, each SO, etc., would elect its own directors to the board.

GENERAL COMMENTS:

- *In addition to or instead of a contractual arrangement, it might be possible to design another mechanism, such as a “springing resignation” signed by each director on assuming office, which would automatically take effect upon a no-confidence vote.*

GENERAL COMMENTS:

- *Member “voting agreements” are not enforceable under California corporate law. So, care will need to be taken to avoid having a contract characterized as a voting agreement. Other mechanisms may be possible too: for example, a “springing resignation” signed by each director on assuming office, which automatically takes effect upon a no-confidence vote.*
- *While a single member structure (where the SOs and ACs are structured as the only member) is possible, this does not resolve the accountability issues identified by the CCWG, but instead recreates them at the member level.*

<u>Designator Model</u>			<u>Membership Model</u>		
Where can right be created?	How can right be exercised?	How can right be enforced?	Where can right be created?	How can right be exercised?	How can right be enforced?
2. Individual Director Recall					
<i>Viable under bylaws.</i>			<i>Viable under bylaws.</i>		
Right in bylaws and backed by statute: Each designator can remove its own designated director(s) at any time for any reason; designator's approval is required before <i>board</i> can remove a designated director <i>without cause</i> .	At designator's discretion or as required under a contract, such as the one described under "Total Board Recall"	If the board or the director in question refused to acknowledge a designator's removal action, the <i>replacement director</i> (or possibly the designator itself) newly named by the designators could bring suit to enforce his/her own appointment.	Right in bylaws and backed by statute: Each member class,* and only that member class, can remove its own elected director(s) at any time <i>without cause</i> . * See Note [1] above under "Total Board Recall".	At the member class's discretion or as required under a contract, such as the one described under "Total Board Recall"	Members can bring suit (1) individually for a failure by the board to follow the bylaws and statute in refusing to acknowledge removals or appointments; and (2) on behalf of the corporation against the board where the corporation has suffered harm, and/or there has been a breach of charitable trust as a result of board action or inaction.
<u>GENERAL COMMENT:</u> <i>The Nominating Committee could be one of the designators in a designator structure in order for it to retain its ability to designate directors, and it could exercise the right to remove directors it had designated as well</i>			<u>GENERAL COMMENT:</u> <i>The Nominating Committee could remain a <u>designator</u> even in a member structure in order for it to retain its ability to designate directors, and it could exercise the right to remove directors it had designated as well</i>		

<u>Designator Model</u>			<u>Membership Model</u>		
Where can right be created?	How can right be exercised?	How can right be enforced?	Where can right be created?	How can right be exercised?	How can right be enforced?
3. Approve Regular Amendments to the Articles or Bylaws					
<i>Approval viable under bylaws; designator-initiated amendments not viable.</i>			<i>Approval viable under bylaws; member-initiated amendments also viable without board approval (in the case of bylaws) and with board approval (in the case of articles).</i>		
<p>Right in articles and bylaws and backed by statute: Corporate law provides that non-member third parties such as designators may be given the right to approve certain or all amendments to the articles of incorporation or bylaws.</p> <p>The approval of a majority of designators, or a higher threshold specified in the articles or bylaws, could be required for amendments to take effect.</p>	<p>Whenever the board proposes and adopts an amendment to the articles or specified (or any) bylaws, the prescribed number of designators must approve the amendment in writing.</p>	<p>(1) Articles: If the requisite approvals have not been obtained, the articles amendment cannot legally be filed with the Secretary of State, and the amendment has no legal effect.</p> <p>(2) Bylaws: If an unapproved amendment implicates the appointment of directors, directors with a claim to office (and possibly designators) can bring suit to enforce an appointment.</p> <p>Otherwise, rights would need to be enforced under contract law (either through a separate contract or by arguing that bylaws were a contract).</p>	<p>Right in articles and bylaws and backed by statute: Corporate law provides that member approval is required for almost all article amendments and for bylaw amendments that affect certain member rights.</p> <p>This right can be extended in the articles or the bylaws to encompass <i>all</i> possible amendments.</p> <p>Likewise, the requisite threshold of approval could be set higher than the threshold required by law (i.e., majority threshold).</p>	<p>Whenever the board proposes and adopts an amendment to the articles or bylaws, the member-approval threshold prescribed by the articles or bylaws and applicable to that particular amendment must be met.</p>	<p>(1) Articles: If the requisite approvals have not been obtained, the articles amendment cannot legally be filed with the Secretary of State, and the amendment has no legal effect.</p> <p>(2) Bylaws: If an unapproved amendment implicates the appointment of directors, members and directors with a claim to office can bring suit to enforce an appointment.</p> <p>Members also have a broad statutory right to sue the board on behalf of the corporation where directors have breached their duties by failing to follow the bylaws and the corporation has suffered harm, and/or there has been a breach of charitable trust as a result of board action or inaction.</p>
<p><u>GENERAL COMMENT:</u> <i>Designators and other non-member third parties may be given at most the right to approve amendments under corporate law; however, unlike members, they may not be given the right to initiate and adopt bylaw amendments or amendments to the articles of incorporation without board approval. (Board approval is still needed for member-initiated amendments to the articles of incorporation, however.)</i></p>			<p><u>GENERAL COMMENT:</u> <i>Members may be given the right to approve amendments under corporate law, and unlike designators, they may also be given the right to initiate and adopt bylaw amendments without board approval, and may also initiate amendments to the articles of incorporation with board approval.</i></p>		

<u>Designator Model</u>			<u>Membership Model</u>		
Where can right be created?	How can right be exercised?	How can right be enforced?	Where can right be created?	How can right be exercised?	How can right be enforced?
4. Approve Changes to “Golden” Bylaws or Articles Provisions					
<i>Approval viable under bylaws; designator-initiated amendments not viable.</i>			<i>Approval viable under bylaws; member-initiated amendments also viable without board approval (in the case of bylaws) and with board approval (in the case of articles).</i>		
Same as for item 3 above, “Approve Regular Amendments to the Articles or Bylaws,” except that the requisite approval threshold presumably would be higher.	Same as for item 3 above; requisite approval threshold presumably would be higher.	Same as for item 3 above.	Same as for item 3 above, “Approve Regular Amendments to the Articles or Bylaws,” except that the requisite approval threshold presumably would be higher.	Same as for item 3 above; requisite approval threshold presumably would be higher.	Same as for item 3 above.

Designator Model

Membership Model

Where can right be created? How can right be exercised? How can right be enforced?

Where can right be created? How can right be exercised? How can right be enforced?

5. Approve Strategic Plan

Reconsideration right potentially viable but unclear; approval not viable.

Reconsideration right viable; approval viable.

<p>Reconsideration right may be provided in bylaws plus a contract among designators; however it is unclear whether a higher board voting threshold could be required, and whether the contract would be enforceable.</p> <p>Approval rights over the plan may not viably be reserved to designators in the bylaws.</p>	<p>Reconsideration rights would be exercised by designators pursuant to procedures described in bylaws and, if used, prescribed in a contract.</p>	<p>If the board refused to follow the reconsideration procedures specified in the bylaws or a contract, then internal escalation could be pursued, and external dispute resolution (e.g. arbitration) mechanisms could be developed to ensure that the procedures are respected, subject to the board’s ultimate decision-making authority and potentially very high standards of review.</p>
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<p>Reconsideration right may be provided in bylaws, including with a higher board voting threshold.</p> <p>Approval rights over the plan may also be reserved to members in the bylaws.</p> <p>Enforceable reserved power, backed by statutory authority, set forth in bylaws. A contract is not required. Supermajority voting obligations, either initially or on reconsideration request, may be imposed by the members on the board.</p>	<p>Exercised by the members pursuant to the procedures described in the bylaws.</p> <p>The bylaws can permit procedures that provide for reconsideration rights or approval rights by the members.</p> <p>Because California law expressly permits approval rights to be reserved to the members, it is not a breach of duties or abdication of responsibilities for the board to adhere to the process or substantive result.</p>	<p>All of the internal and external escalation procedures and dispute resolution mechanisms available to the designators are available to the members, but with no uncertainty as to whether members have standing to pursue such remedies.</p> <p>Members have a broad statutory right, if needed, to sue the board on behalf of the corporation where directors breached their duties by failing to follow the bylaws or statute with resulting harm to the corporation, and/or if a breach of charitable trust has occurred as a result of board action or inaction.</p>
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GENERAL COMMENTS:

- *Bylaws cannot provide a process that deprives the board of its power and obligation to conduct corporate affairs. Directors always retain fiduciary duties and statutory responsibility to conduct ICANN’s affairs.*
- *Directors would be obligated by these duties to disregard a process or decisions that did not comply with law or the mission or core purpose of ICANN as articulated in the bylaws and interpreted by each director. The designators cannot, even with bylaw or contractual provisions, compel the board to act in a manner contrary to these duties, or reserve approval rights over board decisions.*
- *Unless “strategic plan” is well-defined, the power to disrupt board decisions (whether by designators or members) seems amorphous.*
- *Director removal rights under the bylaws, or full board recall rights under contract, could be exercised by designators without resorting to escalation.*
- *It would also be possible to create a procedure for review and forced reconsideration of decisions in a 2-tier board structure, with a larger community board reviewing a decision by the smaller executive board to approve a strategic plan, and then requiring the executive board to reconsider the plan. A 2-tier board structure could be put into place in either the Designator Model or the Membership Model.*
- *Note that the CWG plans to incorporate a community veto right with respect to the strategic plan and budget for the IANA function review.*

GENERAL COMMENTS:

- *Directors always retain fiduciary duties and statutory responsibility to conduct ICANN’s affairs.*
- *Directors would be obligated by these duties to disregard a process or decisions that did not comply with law or the mission or core purpose of ICANN as articulated in the bylaws and interpreted by each director. However, these duties could be made subject to powers reserved to members in the bylaws.*
- *It would also be possible to create a procedure for review and forced reconsideration of decisions in a 2-tier board structure, with a larger community board reviewing a decision by the smaller executive board to approve a strategic plan, and then requiring the executive board to reconsider the plan. A 2-tier board structure could be put into place in either the Designator Model or the Membership Model.*
- *Unless “strategic plan” is well-defined, the power to disrupt board decisions (whether by designators or members) seems amorphous.*
- *Director removal rights under the articles and bylaws and statute, or full board recall rights available to members under contract, could be exercised without resorting to escalation.*
- *Note that the CWG plans to incorporate a community veto right with respect to the strategic plan and budget for the IANA function review.*

<u>Designator Model</u>			<u>Membership Model</u>		
Where can right be created?	How can right be exercised?	How can right be enforced?	Where can right be created?	How can right be exercised?	How can right be enforced?
6. Approve Budget					
<i>Reconsideration right potentially viable but unclear; approval not viable.</i>			<i>Reconsideration right viable; approval viable.</i>		
Same as for item 5 above, "Approve Strategic Plan."	Same as for item 5 above, "Approve Strategic Plan."	Same as for item 5 above, "Approve Strategic Plan."	Same as for item 5 above, "Approve Strategic Plan."	Same as for item 5 above, "Approve Strategic Plan."	Same as for item 5 above, "Approve Strategic Plan."

<u>Designator Model</u>			<u>Membership Model</u>		
Where can right be created?	How can right be exercised?	How can right be enforced?	Where can right be created?	How can right be exercised?	How can right be enforced?
7. Bind Board to Implement IANA Function Review Recommendations					
To be assessed.			To be assessed.		
<p><u>GENERAL COMMENT:</u> The CWG has determined that the IANA function review recommendations should be binding on the ICANN board, and therefore CCWG should consider this additional power in considering the designator versus member models. We will undertake this analysis when directed.</p>			<p><u>GENERAL COMMENT:</u> The CWG has determined that the IANA function review recommendations should be binding on the ICANN board, and therefore CCWG should consider this additional power in considering the designator versus member models. We will undertake this analysis when directed.</p>		