MEMORANDUM

|  |  |
| --- | --- |
| To: | Legal Sub-team of the Cross-Community Working Group on Enhancing ICANN Accountability |
| From: | Sidley Austin LLP and Adler & Colvin |
| Re: | Questions from Samantha Eisner and Pedro Ivo Ferraz da Silva |
| Date: | May 4, 2015 |

**Overview**

This memorandum answers questions posed to Sidley Austin LLP and Adler & Colvin by the Legal Sub-team. This memorandum includes:

* Questions by Samantha Eisner to Sidley Austin LLP with regard to the Sidley Preliminary Draft Responses to CCWG Legal Sub-team Questionnaire ([Link](https://community.icann.org/download/attachments/52890082/Sidley%20Preliminary%20Draft%20Responses%20to%20CCWG%20Legal%20Sub-team%20Questionnaire.pdf?version=1&modificationDate=1427711507000&api=v2)).
* Questions posed by Samantha Eisner to Adler & Colvin regarding the Adler and Colvin Preliminary Responses ([Link](https://community.icann.org/download/attachments/52890082/Adler%20Colvin%20Preliminary%20Responses%20%2800663636xA3536%29.pdf?version=1&modificationDate=1427711471000&api=v2)).
* Questions by Pedro Ivo Ferraz da Silva to both Sidley Austin LLP and Adler & Colvin.

Please note that we retain all qualifications from our prior memoranda to the Legal Sub-team.

**Questions from Samantha Eisner Regarding the Sidley Preliminary Draft Responses to CCWG Legal Sub-team Questionnaire ([Link](https://community.icann.org/download/attachments/52890082/Sidley%20Preliminary%20Draft%20Responses%20to%20CCWG%20Legal%20Sub-team%20Questionnaire.pdf?version=1&modificationDate=1427711507000&api=v2))**

**1. Does the analysis relating to the CCWG change, or are there specific issues that may raise concerns, when taking into consideration that some on the CCWG are contracted parties to ICANN.**

**Answer**: We understand that your question relates to the antitrust analysis that was previously provided on March 27, 2015 ([Link](https://community.icann.org/download/attachments/52890082/Sidley%20Preliminary%20Draft%20Responses%20to%20CCWG%20Legal%20Sub-team%20Questionnaire.pdf?version=1&modificationDate=1427711507000&api=v2)). The prior analysis noted that the formation or operation of entities, groups or associations that include competitors, such as the CCWG and other groups participating in ICANN (whether as members, designators, Supporting Organizations, Advisory Committees or otherwise), is not illegal. Such groups often serve pro-competitive purposes that are clearly permissible under the antitrust laws.

However, the analysis also noted collusion and horizontal group boycotts (also known as refusals-to-deal) among competitors can violate the U.S. antitrust laws, specifically the Sherman Act Section 1. The current question seems to be focused on contracted parties to ICANN that are members of the CCWG and that are actual or potential competitors of one another.

Decisions by ICANN-related groups that would be problematic from a group boycott standpoint would be ones that:

1. make it more difficult, or impossible, for a non-member entity to compete with the member entities, and
2. are not supported by plausible pro-competitive or efficiency enhancing justifications (e.g. effective governance, the effective administration of the domain name system, facilitating interoperability, technical reliability, and stability, etc.).

Decisions that would be potentially problematic from a collusion standpoint would involve anticompetitive agreements among group members who are competitors or potential competitors which disadvantage the members’ customers, and that are not supported by plausible pro-competitive or efficiency enhancing justifications. The pro-competitive justifications, however, will not save a blatantly anticompetitive agreement, such as a price fixing or market allocation agreement.

The risk that ICANN-related groups will engage in anticompetitive activity in the nature of a group boycott or collusion is not a risk that increases to any significant extent under the accountability mechanisms under consideration. Moreover, the risk is manageable as described in our earlier memo and discussed below.

**2. Similarly, are there any prophylactic measures to apply or areas where a community council (generally) or membership organization should exercise care or restraint, when taking into consideration that whatever form the community empowerment model takes it will likely include specific representation for contracted parties? Without providing specific advice to any individual contracted party, is there any guidance on how to address areas where the blockage of a Board vote, or the community invocation of a review mechanism, could have the effect of blocking new entry from potential competitors to those contracted parties? In your next phase of work, would it be useful to consider the history of ICANN’s litigation where ICANN has defended itself and its structure against antitrust suit, and how the evolution of the structure might impact the earlier outcomes?**

**Answer**: To reduce group boycott risk, groups that include competitors should not make decisions or pursue courses of conduct that would have a material, detrimental, competitive effect on a competitor or potential competitor, unless the decisions or conduct legitimately promotes the pro-competitive or efficiency enhancing purpose of the group. The group should memorialize the justifications for decisions and avoid arbitrary or inequitable actions, policies or procedures.

To reduce collusion risk, contracted party group members participating in the CCWG or involved in ICANN whether as members, Supporting Organizations, Advisory Committees or otherwise, should continue to compete with one another in pursuit of their independent economic interests. They should not enter into any agreements with one another that would limit or curtail that competition. They should not share, exchange or discuss commercially sensitive information with one another. They should limit their involvement in the CCWG or relevant ICANN body to activities that further the pro-competitive, efficiency enhancing roles of the relevant group.

Antitrust risk is reduced generally when meetings of groups involving competitors are open, transparent, formal, structured, supervised by counsel and memorialized. Such groups should have clear antitrust policies designed to help members identify and avoid potential problem situations. CCWG and any relevant ICANN-related body should consider this guidance and continue to operate in a transparent and documented manner.

**Questions from Samantha Eisner Regarding the Adler and Colvin Preliminary Responses ([Link](https://community.icann.org/download/attachments/52890082/Adler%20Colvin%20Preliminary%20Responses%20%2800663636xA3536%29.pdf?version=1&modificationDate=1427711471000&api=v2))**

**1. If ICANN were to be converted to a membership based structure (or required some restructuring to incorporate delegates or designators), what impact would that have on ICANN’s not-for-profit public benefit designation under California law, or its 501c3 public charity status as recognized by the U.S. Internal Revenue Service? Would ICANN have to re-apply for any status or designation upon a change?**

**Answer**: Members, delegates, and designators are all permitted under California’s nonprofit public benefit corporation law. There would be no impact on ICANN’s status as a nonprofit public benefit corporation if ICANN were converted to a membership based structure or otherwise undertook some restructuring to incorporate delegates or designators. Similarly, there would be no impact on ICANN’s Section 501(c)(3) tax-exempt status or public charity status. ICANN would not have to re-apply for any status or designation. ICANN will have to file amended articles of incorporation with the California Secretary of State, the content of which will depend on the structure chosen. All significant changes to the governing documents must be reported on its Form 990, which is a public document.

**2. If so, would any of the models under consideration put ICANN’s status/designation at issue, or pose challenges to the likelihood of achieving the same designation?**

**Answer**:Fortunately, no.

**3. For information on the self-perpetuating Board model, that is not something that is currently in practice within ICANN. ICANN's Board currently only has the power to select a single member - the President and CEO. A non-board comprised Nominating Committee (comprised by delegates selected throughout the ICANN community) selects 8 directors, and ICANN's SOs and the At-Large Community select the other 7. Non-voting liaisons are also appointed from entities outside of the ICANN Board. https://www.icann.org/resources/pages/chart-2012-02-11-en.**

**Answer**: We appreciate the explanation.

**4. Can you provide some clarification on how the designator model described within the document is different from the model currently in place within ICANN? Understanding that the current Bylaws do not allow for a designator to remove a selected director (and that is something that is likely to be changed through this accountability work) what else is different here?**

**Answer**: For an explanation of how the designator model differs from the model currently in place within ICANN, please see the Adler & Colvin memorandum of April 14, 2015, ([Link](https://community.icann.org/download/attachments/52890082/ARIN%20Response%20Memo.pdf?version=1&modificationDate=1429059549000&api=v2)), which describes the provisions that would be added in the ICANN governance to establish a full designator model.

**5. Some specific questions are – are you anticipating that the current form of ICANN’s SOs and ACs are sufficient to meet the requirement for the unincorporated associations referred to in your responses? What are the characteristics of the unincorporated associations that would be appropriate for this role?**

While we have not yet conducted a full and detailed review of each SO and AC, it appears to us that the existing forms are close to sufficient such that, with some additional steps, they can each fulfill the requirements for unincorporated associations, which are minimal. Please see the legal counsel memorandum entitled “Response to Questions Re: Unincorporated Associations” of April 23, 2015 ([Link](https://community.icann.org/download/attachments/52890082/Sidley-Adler%20-%20Memo%20%28Unincorporated%20Associations%29.pdf?version=1&modificationDate=1430069090000&api=v2)), with a discussion of the unincorporated association form. The SOs and ACs could establish themselves as unincorporated associations for purposes of exercising their rights as members or designators with these fairly simple formalities:

* Preparing short articles of association or other charter document;
* Determining who will participate in the association and describing that participation generally in the short articles of association or other charter document referred to above;
* Cross-referring to the ICANN Bylaws for most aspects of governance; and
* Filing a short statement with the California Secretary of State (if desired);

**6. How is the ICANN Nominating Committee different from the group of entities that is discussed as coming together to be the collective designators acting together/the “constellation” referred to in the memo?**

**Answer**: The ICANN Nominating Committee already acts very much like the group of entities that might come together to be a collective designator. The additional step would be to form an unincorporated association that would be the legal entity acting as designator. Within that unincorporated association, the Nominating Committee process could occur as described in the ICANN Bylaws. Alternatively, the Nominating Committee could be reformulated as a Delegate Council comprised of SOs, ACs, and other stakeholders, so long as all entities (including the IETF) appointing voting delegates were statutory members of ICANN. Additional information is available in the legal counsel memorandum entitled “Nominating Committee: Legal Role and Status” of April 29, 2015 ([Link](https://community.icann.org/download/attachments/52890082/Memo%20-%20Nominating%20Committee%20-%20Legal%20Role%20and%20Status.pdf?version=1&modificationDate=1430441923000&api=v2)).

**7. Page 5 – The ICANN Bylaws currently require indemnification of directors to the extent allowed by law. What are the implications of such a provision being in place if ICANN were to move to a “super board” with a majority of directors not holding a fiduciary duty to the organization? What are the governance and accountability implications for this?**

**Answer**: Under the California nonprofit public benefit corporation law, directors, by definition, have fiduciary duties. We cannot create a true board (one with power to govern the corporation) with no fiduciary duty. (At the legal discussion on April 14, 2015, we discussed a model involving a very large Board that delegates everything legally possible to a smaller Executive Committee, on which, for the most part, the other directors may rely to discharge their fiduciary duties. In this model, which we understand is not under consideration, both “Boards” remain fiduciaries.) To the extent individuals serving on a “superboard” are not directors but are acting as ICANN’s agents, ICANN would still be permitted to indemnify them, within the limits and following the procedures set out in Section 5238 of the California nonprofit public benefit law. If you would like more information on indemnification under that Section, we are happy to provide that under separate cover.

**8. Page 5 – Also relating to the size of the Board - ICANN currently allows its directors to elect to receive compensation. In considering changes to the structure of ICANN's Board, it's probably necessary to include consideration of whether other items, such as compensation, should be revisited, and how such changes interact with the historical basis for taking decisions (i.e., board compensation was recommended through ATRT1), as well as issues of accountability and governance. This may not be a legal question for the advisors, but something for the CCWG to consider if it will be recommending a change to the Board size.**

**Answer**: Both California law and the Internal Revenue Code are fairly lenient on reasonable compensation of directors for their service as directors (e.g., attending meetings of the Board and committees, travel time and expense, time spent in study and communications regarding Board decisions). The time and effort required for their Board service, not the size of the Board, would affect whether compensation is reasonable and not excessive.

If any directors were separately compensated by ICANN for services such as executive employment or expert consultations, some legal restrictions and standards would apply. For instance,

* no more than 49% of the Board (or certain relatives) could be compensated in that way;
* the compensation must be fair and reasonable;
* The Board would need to determine that a better arrangement could not have been obtained with reasonable effort under the circumstances; and
* The compensation may not provide excess benefit to the director (based on comparability data and following a conflict of interest disclosure process with the director absent during the final vote).

**9. Is payment for membership required?**

**Answer**: No, the law does not require a corporation to impose dues or any other payment on its members.

**10. Page 7 includes discussion of internal decision-making of the various members of the organization. Where would commitments of accountability to other members/broader ICANN community be housed? Could there be broad principles developed for members, with the requirement that individual internal operating procedures be drafted in line with those? How do we assure that the membership concept allows for the introduction of future participants?**

**Answer**: Exactly as you suggest, commitments of accountability to be required of ICANN members could be set forth in the bylaws, in general terms, with authority delegated to the Board to develop specific policies and procedures on expectations of member conduct. These could be important in the event of member misbehavior, if ICANN might ever need to internally discipline a member for actions jeopardizing the best interests of ICANN, including its external obligations or commitments. Internal ethical standards have proved to be very important to maintaining the integrity of member-based nonprofit corporations.

The membership concept can allow for the introduction of future members, or their departure, merger, or other changes in the community of constituents, through the process of amending the ICANN bylaws from time to time. We recommend that an organization like ICANN, with a small number of voting members, identify those entities that are members at any given time, including their right to directly or indirectly select directors, state their weighted voting power, and assign them to classes, in the bylaws. Each time a new member class is added, the members, voting by class, would need to approve the bylaw amendments because their relative voting rights will be weakened; removing a member class would not legally require approval by each class.

**11. Page 9 – Can you provide some clarity on who the party/parties are with whom ICANN would be contracting? It’s not quite clear which whom ICANN is suggested to contract with and what consideration is provided as the basis for the contract. Is this considered a broad solution, or a specific solution for those who are already under contract with ICANN?**

**Answer**: The use of contracts in ICANN’s governance was envisioned as a means to compel coordinated action by members or designators triggered by specific events. For example, if contracts instead of springing resignations were used as the mechanism for total board recall, the contracts could be among the members or the designators themselves, or between each member/designator and the corporation, or possibly with some other counterparty. Ultimately, the identity of the parties and the consideration to be exchanged depends on many things, including whether a member or designator model is chosen, so the details have not yet been fleshed out. Moreover, care must be taken that any contractual arrangements not violate either the fiduciary duties of directors, or the prohibition on member voting agreements, imposed by California law. The key point, however, would be to compel each member or designator to remove its directors (or possibly take some other action), where the member or designator might not otherwise wish to do so, and where corporate law does not provide for a mechanism to accomplish the desired action.

**Questions from Pedro Ivo Ferraz da Silva**

1. **Are there any restrictions in California law or in applicable federal US-law with respect to government officials (US or foreign) becoming statutory members (or designators) of a non-profit organization? Would all liabilities applied to US or foreign citizens in a membership (or designator) structure  equally apply to a government official which has legal immunity and privileges in the United States?**

**Answer:**  No. Neither California corporate law nor the U.S. federal tax law under which ICANN is exempt from taxes, nor any other state or federal law of which we are aware restricts who may be a member or designator of ICANN based on the person’s status as a U.S. or foreign government official. Under certain circumstances the codes of conduct and ethical rules that apply to certain US government officials may restrict their ability to serve, however.

If a foreign government official has legal immunity and privileges in the US, those immunities and privileges could very well extend to potential liabilities related to service as a member or designator in relation to ICANN. (This question is too general to answer with great specificity since it will depend on the nature of the immunity and privileges granted). Members of a nonprofit corporation generally are not liable for the acts of the corporation under the California Corporations Code. Such liability protections do not clearly apply to designators.

**2. What are the specific legal requirements for a third-party which may have approval or veto rights over board decisions and what are its liabilities?**

**Answer:** As a matter of corporate law, only *members* may be given the right to approve or override board decisions generally (and this right is subject to certain limitations based on the type of decision at issue as explained in our memo Legal Assessment: Executive Summary, Summary Chart and Revised governance Chart [[Link](https://community.icann.org/download/attachments/52890082/sidley%20Legal%20Assessment%20-%20Executive%20Summary%2C%20Summary%20Chart%20and%20Revised%20Governance.pdf?version=1&modificationDate=1430068991000&api=v2)]). Both members and third parties, including designators, may be given the right to veto certain amendments to the articles or bylaws approved by the board. Both members and designators need to be legal persons (e.g., natural persons or constituted as a legally recognized entity such as a corporation or an unincorporated associations) in order to be able to enforce their rights. Under corporate law, neither members nor designators owe any fiduciary duties to ICANN to act in its best interests, so neither would be exposed to any additional liability for decision made by the members or designators -- except in theory in the extreme situation where the extent of member powers over board decisions was so great that the members became *de facto* directors. A member right to approve budgets or strategic plans would not rise to that level of concern.

Of course, as is currently the case, if a legal person, whether an SO or AC member or designator or otherwise, entered into a contract with a third party and breached that contract, or engaged in tortuous conduct the member or designator could be exposed to liability to the aggrieved party, but any such exposure would be entirely independent of anything in ICANN’s governing documents: it would arise from actions taken by the member or designator on its own initiative. Such claims are equally possible now, under ICANN’s current structure, although the persons exposed to this risk are the individuals participating in the Sos and ACs.

**3. Could a community veto  (be it exercised in a membership or a designator structure) over a bylaw change potentially be reverted through a court decision in California?**

**Answer:**  Assuming a properly-drafted provision in the bylaws gave the veto power to the members or designators, and they exercised the right following proper legal procedures, then no, a court would have no basis to reverse the veto.

**4. The fact that the "board bears ultimate responsibility for corporate decisions and must provide oversight of the exercise of those powers it has delegated" (Sidley Austin LLP, Initial Discussion Draft 1, p. 3) implies that the board may eventually revert a community veto (member or designator structure) over its own decision or over the budget it has originally approved?**

**Answer:** To reiterate, only members, not designators, could be given the right under the bylaws to override a specific board action, such as a board vote to approve the budget. The only exceptions are that designators may be given the right to veto an articles or bylaws amendment, or veto the board’s not-for-cause removal of a director appointed by the designator. *If the bylaws provide that member approval is required for adoption of ICANN’s budget, the board could not legally reverse a member decision not to approve the budget.* This narrow exception for member actions to the board’s general authority and responsibility for corporate actions, is in the corporate statute; the cited text was a general statement of the law.

**5. Is the Californian Attorney General able to intervene in ICANN's operations upon the complaint of a government (US or other)? How does this situation (“this situation” meaning: where the California Attorney General intervenes in ICANN’s operations at the behest of the US or other government) relate to norms of international private law internalized by the United States?**

**Answer:** The Attorney General has broad authority to intervene in corporate affairs of a California nonprofit public benefit corporation, whether on the complaint of another governmental agency or otherwise.  However, in our experience, the Attorney General will not intervene in a charity’s internal governance unless misuse or misspending of substantial charitable assets is alleged.  If the Attorney General receives information or a viable complaint about a charity involving the misspending of significant charitable assets, the Attorney General may examine the charity’s affairs, including the corporate governance mechanisms that allowed the alleged misspending to occur.  These complaints and/or information might come from a variety of sources, including charity insiders, the media, the general public, or other government agencies (such as the U.S. Internal Revenue Service).

The law enforcement powers of the Attorney General would be consistent with international legal norms; law enforcement in all countries have similar powers over companies under their jurisdiction.  The Attorney General’s ability to lawfully intervene would be limited to enforcing the law, and ultimately the courts could enjoin unlawful actions by a state’s Attorney General.

(Please refer to the March 27 Adler & Colvin preliminary response to Question 7, which provides further background on the topic of intervention by the California Attorney General in internal charity operations. [[Link](https://community.icann.org/download/attachments/52890082/Adler%20Colvin%20Preliminary%20Responses%20%2800663636xA3536%29.pdf?version=1&modificationDate=1427711471000&api=v2)])