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MEMORANDUM

TO: Cross-Community Working Group on Enhancing ICANN Accountability

FROM: Sidley Austin LLP and Adler & Colvin

DATE: October 12, 2015

RE: Responses to Questions Concerning Director Fiduciary Duties under California Corporate Law

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On October 6, 2015, you asked us to reply to three questions concerning the fiduciary duties of directors of California nonprofit public benefit corporations such as ICANN. This memorandum[1] responds to that request.

EXECUTIVE SUMMARY

California law imposes on the individual directors of a nonprofit public benefit corporation, rather than the board collectively, the duty to make every decision in good faith with loyalty to the corporation's best interests, and with the due care of an ordinarily prudent person in a like position under similar circumstances. As a charity, ICANN holds its assets in trust for charitable purposes, which together with other considerations inform ICANN's directors as they determine the corporation's best interests.

So long as a director has exercised his or her fiduciary duties in making a decision, courts will defer to the director's business judgment about the corporation's best interests, and the director will not be held personally liable for resulting damages to the corporation. Governance documents cannot alter the scope of the subjectivity and judgment that the law preserves for directors. Moreover, since reasonable people can reach different conclusions after careful consideration of the same set of facts, enforcing directors' fiduciary duties will not ensure that the community's view of the public interest will prevail, even if a court or arbitrator agreed with it. Consequently, it is not possible either to constrain directors

[1] **Note as a general matter that our legal analysis is provided on a level in keeping with the question posed. Our legal analysis is tailored to the context in which the particular question arises. It is provided to inform and help facilitate your consideration of the governance accountability models under discussion and should not be relied upon by any other persons or groups for any other purpose. Unless otherwise stated, our legal analysis is based on California law and in particular the laws governing California nonprofit public benefit corporations (California Corporations Code, Title 1, Division 2). In our effort to respond in a limited time frame, we may not have completely identified, researched and addressed all potential implications and nuances involved.**

from citing their fiduciary duties as a reason for a given course of action, or to codify fiduciary duties under the Bylaws in a way that will compel a result desired by the community.

ANALYSIS

Question 1. What are a director's fiduciary duties to a California nonprofit public benefit corporation?

Overview. The activities and affairs of a nonprofit public benefit corporation such as ICANN must be conducted, and all corporate powers exercised, by or under the direction of the board of directors, subject only to any requirement for member approval.[2] In making board decisions, each director must comply with fiduciary duties. Note that fiduciary duties apply to directors individually, not to the board as a whole. The directors vote, and the collective outcome is the board's decision, but the board as such has no fiduciary duties.

Corporate law specifies the fiduciary duties of directors:

> A director shall perform the duties of a director . . . in *good faith*, in a manner that director *believes to be in the best interests of the corporation* and with *such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.* (Emphasis added.)[3]

This section includes three basic requirements: a duty of loyalty to the corporation, a duty to act with appropriate care given the situation, and a general obligation always to act in good faith. A director who breaches any of these duties to the corporation may be personally liable to the corporation for any resulting damages to the corporation.

A director fulfills the duty of loyalty by acting in the corporation's interests, as opposed to the director's personal interests or the interests of any other person. Breaches of the duty of loyalty typically arise when a director, a relative of a director, or an entity in which a director has an interest, either tries to compete with the corporation or seeks to enter into transactions with the corporation (often called "self-dealing"). The law permits, but subjects to high scrutiny, self-dealing transactions that benefit the corporation.[4]

While the duty of loyalty focuses on the corporation's interests rather than those of any other person including the director, the language of the statute includes a subjective component: the director must act in what he or she *believes* to be the corporation's best interests. In other words, the law acknowledges that exercising fiduciary duties requires a director to determine what he or she thinks a corporation's best interest is. The corporation's best interest is

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[2] California Corporations Code Section 5210. The California Corporations Code includes the California Nonprofit Public Benefit Corporation Law, comprised of Sections 5110-6910 of the Code, plus general provisions and definitions in Sections 5002-5080. All section references in this memo are to the California Nonprofit Public Benefit Corporation Law, unless otherwise noted.

[3] Section 5231(a).

[4] Section 5233.

not an absolute: a director must take into account competing interests of the corporation under the specific circumstances existing when the decision is being made, and different directors may legitimately come to different conclusions, both as to what the corporation's best interests are and how to achieve them.

A director fulfills the duty of care by exercising due diligence in reaching a decision, as measured by what an "ordinarily prudent person" in similar circumstances would do. Breaches of the duty of care can arise where, for example, a director fails to attend board meetings, fails to review information provided to the board, fails to follow up on information provided when it warrants action, or fails to obtain adequate information on which to base a decision. In fulfilling their duties, directors are legally entitled to rely on information from various sources, such as board committees, officers and employees, and appropriate outside experts, provided the reliance is reasonable.[5]

The Business Judgment Rule. As discussed above, the exercise of fiduciary duties unavoidably involves a significant degree of judgment and subjectivity. Two directors fulfilling their fiduciary duties could reach different conclusions: reasonable people can disagree. Corporate law protects directors from claims that they breached their fiduciary duty where the reality is merely a disagreement with the director's judgment, through the "business judgment rule."

Under this rule, courts will not second-guess the decisions of directors who acted in good faith, without personal interest, and with due care – i.e., in compliance with their fiduciary duties – even if the decision later turns out to have been inconsistent with the best interests of the corporation or its charitable purposes. The statute provides as follows:

> Except [for self-dealing transactions], a person who performs the duties of a director in accordance with [his/her fiduciary duties] shall have *no liability based upon any alleged failure to discharge the person's obligations as a director, including . . . any actions or omissions which exceed or defeat a public or charitable purpose to which a corporation, or assets held by it, are dedicated*.[6]

Seen in this light, the fiduciary duties of corporate directors are about *process* and *behavior* – whether each director acted with the requisite due care and loyalty – rather than addressing the *substance* of the decision each director has reached. The business judgment rule permits each director a reasonable degree of judgment in balancing a corporation's many interests, of which achieving its charitable purposes is one, albeit among the most important; and protects each director's subjective assessment of what the corporation's best interests are. All directors can act in the best interests of the corporation as each sees them in light of his or her particular experience, within the standards of loyalty and prudent action described in the law, yet reach quite different conclusions and vote accordingly. So long as all have fulfilled their fiduciary duties – acting on an informed basis and without conflict of interest – none will be liable to the

[5] Section 5231(b).

[6] Section 5231(c).

corporation for breach, even if the board's collective decision turns out with the benefit of hindsight to have harmed the corporation.

Effect of Members on Director Fiduciary Duties. If a nonprofit public benefit corporation has members (including a sole member), then, in addition to the statutory rights of members, the Bylaws may grant to members reserved powers to make specific decisions. If extensive powers are given to the members to control the corporation, courts may impose fiduciary duties on the members. (We have advised elsewhere[7] that the budgetary, strategic and operating plan, and IANA review powers sought by the CCWG are not of concern in this regard.)

If the members exercise a reserved power, the member decision binds the corporation; the board's role is then to conduct the corporation's affairs in accordance with that member decision. The directors cannot breach their fiduciary duties with respect to a decision that the Bylaws give the members, and not the board, the right to make. In a sense, the members' exercise of their reserved power protects the directors from a claim of breach of duties, or relieves the directors of their fiduciary duties, for the members' decision. However, the directors continue to have fiduciary duties to the corporation in implementing the member decision.

Question 2. What is the relationship of a corporation's purpose or mission as stated in its governing documents to these fiduciary duties?

Unlike the directors of a California business corporation, who owe fiduciary duties to the corporation *and* its shareholders, directors of a California nonprofit public benefit corporation like ICANN owe a fiduciary duty to act in the best interests of the corporation alone. ICANN's interests include furthering its purpose to benefit the public, including the various constituencies it serves. Its interests also include operating in compliance with applicable law. The law that requires ICANN to use its assets strictly to further its charitable purposes is the "charitable trust doctrine" developed by California courts.[8]

The charitable trust doctrine, despite its name, applies to public benefit corporations as well as to entities in trust form. The central principle of the doctrine is that all the assets of a nonprofit public benefit corporation like ICANN[9] are, by law, *impressed with a charitable trust*: They may only be used for the specific charitable purposes stated in the

[7] Please see, for example, the memorandum answering questions posed by Samantha Eisner and Pedro Ivo Ferraz da Silva, dated May 4, 2015, on page 8, question 2.

[8] Some other U.S. states recognize a "duty of obedience" to the purpose for which the corporation was formed as provided in the Articles of Incorporation. The California Corporations Code does not include a duty of obedience as among directors' fiduciary duties, but essentially the same result is reached through the doctrine of charitable trust.

[9] Although ICANN is unlike a traditional "charity" organized for the relief of poverty or the provision of health care or education, it nonetheless is regarded as such for purposes of California law. The term is used here to refer to entities that are formed to benefit the public or a charitable class, and that are exempt from taxes under Section 501(c)(3) of the U.S. Internal Revenue Code, which describes ICANN.

corporation's Articles of Incorporation as further limited in the Bylaws.[10] Although ICANN holds legal title to its assets, it holds them not for its own benefit or the benefit of its officers, directors, employees, or any other private parties, but in trust for the public. ICANN is responsible for the stewardship of its charitable assets and may use them only to operate in furtherance of its charitable purposes.

However, even though ICANN is legally bound to use its assets only to further its charitable purposes, and a director's fiduciary duties generally require operating ICANN in compliance with that legal requirement, the requirement does not eliminate all director discretion. Merely complying with the law or charitable purposes does not dictate a single course of action. Directors may reasonably develop varying views of ICANN's best interests and its charitable purposes, and how best to achieve them. Accordingly, the power to hold directors accountable through enforcing their fiduciary duty to follow ICANN's purposes in its Articles and Bylaws is limited in practice, and as the statute expressly provides, even an action outside ICANN's charitable purposes would not necessarily indicate that directors had breached their fiduciary duties in approving it.

For example, consider a nonprofit public benefit corporation that was in a dire financial situation. A director could favor cutting back on the level of services provided – for example in public-assistance programs – to preserve the corporation's financial health and its long-term ability to fulfill its charitable purpose. Conversely, another director could favor dissolving the corporation and granting all remaining assets to another nonprofit with a similar mission in a healthier financial condition, on the argument that the other organization could more effectively carry out the corporation's original charitable purposes. The directors in this example have reached very different conclusions about the best interests of the corporation, yet either decision would be protected by the business judgment rule, and if the board decided to undertake either course of action, the directors who voted in favor would not be personally liable for any resulting damages, *so long as the director's decision was made with due care and on the basis of sufficient information and without a conflict of interest*.

We note that some may see fiduciary duties as a tool for compelling the board to reach a specific result. For example, to the extent the Bylaws require ICANN to operate for the benefit of the global Internet community, some may assume that any board decision contrary to what the SOs and ACs collectively view as benefiting the entire Internet community would lead to director liability, with fiduciary duties requiring directors to act in accordance with the collective view. That assumption misconstrues the fundamental nature of fiduciary duties. If an action were brought against those directors who voted in favor of a decision that did not, in the collective view, benefit the entire Internet community, a court would consider whether the directors acted in good faith, in what they believed to be ICANN's best interests, and with

[10] Charitable purpose restrictions on assets can also be imposed by donors at the time of gift, or arise from the terms of a solicitation to which a donor responds by giving. For purposes of this memorandum, we assume neither of these is a significant source of restrictions on funds held by ICANN, but to the extent ICANN holds any such restricted funds, ICANN is required to honor those restrictions. In the event of any inconsistency between purpose statements in Articles of Incorporation and Bylaws, the Articles govern. Bylaws may narrow, but not expand, a corporation's charitable purposes.

reasonable care during the decision-making process. If they did, the directors would have no liability.[11]

3. Is there any means under Californian Law to subject the exercise of fiduciary duties to objective and controllable standards?

(a) *Can the Bylaws concretize the directors' fiduciary duties?*

No. The Bylaws can restate what the law says but cannot modify it. Suppose, for example, the Bylaws sought to concretize the directors' exercise of the duty of care by requiring the board to obtain legal opinions from at least two different law firms before they could act contrary to a community directive. In certain circumstances, this step might be prudent, enhancing the exercise of the directors' duty of care. In other circumstances, however, it could be a waste of corporate assets, and directors could legitimately determine that the expense was not in the best interests of the corporation and thus not consistent with their fiduciary duties. The point is that the law preserves a significant degree of subjectivity for the directors to make their decisions in light of what they deem best for the corporation under changing circumstances, within the broad scope of what an ordinarily prudent person in a like position would do under similar circumstances. Any provision of the Bylaws that attempted to curtail the exercise of fiduciary duties by prescribing the specific manner in which they were to be applied could be ruled invalid.[12]

(b) *Can the Bylaws subject the correct interpretation of fiduciary duties to arbitration?*

Not in any binding arbitration. Each individual director is required to determine, for himself or herself, what is in the best interests of the corporation through the exercise of his or her fiduciary duties. California corporate law does not permit a board to agree *ex ante* (beforehand) to arbitrate its core fiduciary duties. Both statutes and case law restrain this power, and they attempt to ensure that the board of directors exercises its fiduciary duties and governs the corporation. The California Corporation Code and court decisions strongly suggest that a nonprofit board could not legally agree to binding arbitration regarding its "core" fiduciary duties because a "board must retain the ultimate freedom to direct the strategy and affairs of the

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[11] At some extreme point, a court (or, conceivably, an arbitrator) might reverse a board decision. For example, in the case *Queen of Angels v. Younger*, 136 Cal. App. 359 (2d Dist. 1977), the California appellate court invalidated the decision of a hospital board to lease the hospital to a for-profit company and to use the proceeds to operate outpatient clinics, because to do so would violate the central purpose to which the organization had been dedicated in its governing documents and its operational history: namely, running an inpatient hospital. The court in *Queen of Angels* did not address whether the directors had breached their fiduciary duties in making the decision that was reversed. Conceivably, an egregious breach of charitable trust, such as a patently unwise decision to undertake a new program or to invest in risky derivatives, would itself influence a court's determination of whether directors had acted in good faith or reasonably. The acceptable area for subjective decision-making is broad, however, and generally California law would protect a director if he or she had acted in conformity with his or her fiduciary duties as a procedural matter.

[12] The Articles of Incorporation and the Bylaws may contain any provisions for the management of the activities and the conduct of the affairs of the corporation, except for provisions in violation of law. *See* Sections 5132(c)(5) and 5151(c).

Company."[13] This inherently involves some discretion within the wide bounds of the "ordinarily prudent person" measure, and two directors can reach opposite conclusions while fully complying with their fiduciary duties. The law permits directors to reasonably rely on the assistance of professional advisors as they determine what is in the best interests of the corporation (for example, by obtaining advice from legal counsel on the interpretation of a contract), but an outside arbitrator cannot instruct them on correctly interpreting their fiduciary duties so as to compel a specific decision. Any agreement in which a Board consents to binding arbitration of core fiduciary duties would likely not be enforceable. Courts will not "give legal sanction to agreements which have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters."[14] Neither statute nor precedent establishes a clear line between non-delegable core fiduciary duties and duties that may permissibly be subjected to binding arbitration. What constitutes a core fiduciary duty would depend on the particular issues presented, but it would likely include issues of strategic plans, operations, budget, and corporate separations (such as the separation of the PTI).

Any such arbitration would be shaped by the standard of review selected by the parties in the arbitration agreement. The standard of review could be compliance with the Articles and Bylaws as understood within the context of applicable law,[15] or it could be a more procedural set of rules.

Please see the attached Appendix, "Arbitrability of Fiduciary Duties of Nonprofit Corporate Boards," for further discussion.

(c) ***Can the Bylaws impose special requirements on the rationale the board needs to provide when they wish to override community decisions?***

The Bylaws can definitely require improved board transparency, so that the Internet community and general public can better understand how and why the board reached a given decision. Examples could include a requirement to transcribe and publish board discussions or to hold board meetings open to the community. But different directors may have different reasons for casting the same vote, and will almost certainly have different reasons for casting different votes, so a single board rationale for a collective decision to override a community decision may well not exist.

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[13] *In re Bally's Grand Derivative Litig.*, No. Civ. A. 14644, 1997 WL 305803, at *4 (Del. Ch. June 4, 1997) (internal quotation marks omitted); *Kennerson v. Burbank Amusement Co.*, 120 Cal. App. 2d 157, 173 (Cal. Dist. App. Ct. 1953); Marsh, Finkle & Sonsini, *Marsh's Corporation Law* § 10.02 (2015) (noting that California requires the board to retain ultimate governing control).

[14] *Abercrombie v. Davies*, 123 A.2d 893, 899 (Del. Ch. 1956) (Seitz, J.), *rev'd on other grounds*, 130 A.2d 338 (Del. 1957); *see also Chapin v. Benwood Found., Inc.*, 402 A.2d 1205, 1210 (Del. Ch. 1979) (prohibiting directors from "delegat[ing] to others those duties which lay at the heart of the management of the corporation"). Similarly, other courts have held that a board may not "divest itself of its fiduciary obligations in a contract." *Jewel Cos. v. Pay Less Drug Stores Northwest, Inc.*, 741 F.2d 1555, 1563 (9th Cir. 1984) (citing, *inter alia*, *Trumbo v. Bank of Berkeley*, 176 P.2d 376 (Cal. Ct. App. 1947)); *see also Compton Coll. Fed. of Teachers v. Compton Cmty. Coll. Dist.*, 183 Cal. Rptr. 341, 347 (Cal. Ct. App. 1982) ("A board of directors of a private corporate cannot delegate away its responsibility to govern the corporation.").

[15] The arbitration agreement would need to include some legal context, such as whether Bylaws were to be read in light of California law as currently interpreted by the California Supreme Court.

We could consider further whether each director could be required to provide in a transparent manner the rationale for his or her vote to demonstrate the exercise of that director's fiduciary duties, if that were deemed desirable.

(d) ***Can the Bylaws impose extra-supermajorities in the board in order to be able to invoke such duties?***

No. First, as explained above, fiduciary duties apply to individual directors, not to the board as a whole–the board itself does not "invoke" fiduciary duties. Second, fiduciary duties apply to every action a director takes as a director. Whether a director agrees with a community position or not, in the absence of a member reserved power, the director should *always* be acting in compliance with his or her fiduciary duties, which as we explained above can lead to reasonably different conclusions among individual directors.

The Bylaws *may* require very high majorities for the board to take specified actions, such as approving a Bylaws amendment or adopting a budget over the community's declared opposition, but we do not understand this to be the point of the question.

APPENDIX

Arbitrability of Fiduciary Duties of Nonprofit Corporate Boards

This Appendix addresses the question of whether a California nonprofit public benefit corporation's board of directors may agree to submit itself to a binding arbitration process that could ultimately require the board to exercise its fiduciary duties[1] in accordance with the arbitration panel's order, and if so, to what extent. In addition, it considers whether there is likely to be a difference between the duties that a one-member corporation could delegate versus those of a corporation without members.

An arbitration panel is a contractually created dispute-resolution forum.[2] Thus, the question is whether there are limits on the extent to which a board may delegate its decision-making authority. California, like most states, requires a board of directors to conduct "the activities and affairs of the corporation" and exercise "all corporate powers," including the power to contract. Cal. Corp. Code § 5210. The board, in turn, may delegate much of the day-to-day operations of the corporation, and so long as "[a]n informed decision to delegate a task" is made, courts will consider it "as much an exercise of business judgment as any other."[3] After all, "[t]he realities of modern corporate life are such that directors cannot be expected to manage the day-to-day activities of a company."[4]

A board's power to delegate, however, is not boundless. California corporate law does not permit a board to agree *ex ante* (beforehand) to arbitrate its core fiduciary duties. Both statutes and case law restrain this power, and they attempt to ensure that the board of directors exercises its fiduciary duties and governs the corporation. The California Corporation Code and court decisions strongly suggest that a nonprofit board could not legally agree to binding arbitration regarding its "core" fiduciary duties because a "board must retain the ultimate

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[1] More than the board's traditional fiduciary duties of due care, loyalty, and good faith, this memorandum uses the term "fiduciary duties" as a shorthand for the directors' duty to govern the corporation. *See* Cal. Corp. Code § 5210; *Kennerson v. Burbank Amusement Co.*, 120 Cal. App. 2d 157, 173 (Cal. Dist. App. Ct. 1953) ("As long as the corporation exists, its affairs must be managed by the duly elected board. The board may grant authority to act, but it cannot delegate its function to govern.").

[2] *AT&T Techs., Inc. v. Commc'ns Workers of Am.*, 475 U.S. 643, 648 (1986) ("[A]rbitration is a matter of contract.").

[3] *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 943 (Del. 1985) (citing *Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1984)). *But see Grimes v. Donald*, No. Civ. A. 13358, 1995 WL 54441, at *7 (Del. Ch. Jan. 11, 1995), stating "whether these contracts are valid or not does not fall into the realm of business judgment; it cannot be definitively determined by the informed, good judgment of the board. It must be determined by the court."

[4] *Rosenblatt* at 943. "Today, the most prevalent standard by which to judge the conduct of directors of not-for-profit corporations is by the same standard as that applied to business corporations." Gary Lockwood, Law of Corporate Officers and Directors: Rights, Duties & Liabilities § 21:6 (2014); *see also Boston Athletic Ass'n v. Int'l Marathons, Inc.*, 467 N.E.2d 58, 63 (Mass. 1984) ("Principles of corporate governance with respect to the power of the board of governors to delegate authority to individual officers are applicable to profit and nonprofit corporations alike.").

freedom to direct the strategy and affairs of the Company."[5] Neither statute nor precedent establishes a clear line between non-delegable core fiduciary duties and duties that may permissibly be subjected to binding arbitration. What constitutes a core fiduciary duty would depend on the particular issues presented, but it would likely include issues of strategic plans, operations, budget, and corporate separations (such as the separation of the PTI).

That said, California allows member-based nonprofit corporations to reserve significant rights with respect to corporate decision-making—and does not grant such rights to other third parties. Accordingly, a corporation with members (or with a sole member) member could subject more matters to an arbitration process than a in non-membership based structure.

I. A board may not submit exercise of "core" fiduciary duties to arbitration.

As noted above, California law requires "[e]ach corporation [to] have a board of directors" that exercises the powers of the corporation and each director acts as a fiduciary of the corporation. Cal. Corp. Code § 5210. "The board may delegate the management of the activities of the corporation to any person or persons, management company, or committee however composed, provided that the activities and affairs of the corporation shall be managed and all corporate powers shall be exercised *under the ultimate direction of the board*." *Id.* (emphasis added). The California courts have not determined the precise limits of the italicized text, but with respect to for-profit corporations, the California Supreme Court has held in *Wells Fargo Bank v. Superior Court*, 811 P.2d 1025, 1033 (Cal. 1991) (*en banc*), that "a board of directors has no power to delegate the performance of its basic powers and functions, particularly its statutory prerogatives, in the absence of express statutory authority."

While *Wells Fargo* does not specifically address the powers and duties of a nonprofit board, it fits with the well-established case law of other jurisdictions, which prohibit a board or individual directors from abdicating certain responsibilities. As the Delaware Chancery Court explained in *Abercrombie v. Davies*, 123 A.2d 893, 899 (Del. Ch. 1956) (Seitz, J.), *rev'd on other grounds*, 130 A.2d 338 (Del. 1957) courts will not "give legal sanction to agreements which have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters."[6] Similarly, other courts have held that a board may not "divest itself of its fiduciary obligations in a contract."[7]

In the absence of statutory authorization or case law that supports a different conclusion, the *Wells Fargo* case and the reasoning of the other cases cited indicates that under California

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[5] *In re Bally's Grand Derivative Litig.*, No. Civ. A. 14644, 1997 WL 305803, at *4 (Del. Ch. June 4, 1997) (internal quotation marks omitted); *Kennerson v. Burbank Amusement Co.*, 120 Cal. App. 2d 157, 173 (Cal. Dist. App. Ct. 1953); Marsh, Finkle & Sonsini, *Marsh's Corporation Law* § 10.02 (2015) (noting that California requires the board to retain ultimate governing control).

[6] *See Chapin v. Benwood Found., Inc.*, 402 A.2d 1205, 1210 (Del. Ch. 1979) (prohibiting directors from "delegat[ing] to others those duties which lay at the heart of the management of the corporation").

[7] *Jewel Cos. v. Pay Less Drug Stores Northwest, Inc.*, 741 F.2d 1555, 1563 (9th Cir. 1984) (citing, *inter alia*, *Trumbo v. Bank of Berkeley*, 176 P.2d 376 (Cal. Ct. App. 1947)); *see also Compton Coll. Fed. of Teachers v. Compton Cmty. Coll. Dist.*, 183 Cal. Rptr. 341, 347 (Cal. Ct. App. 1982) ("A board of directors of a private corporate cannot delegate away its responsibility to govern the corporation.").

law a nonprofit public benefit corporation's board may not constrain its core obligations to use its judgment in managing the affairs of the corporation by agreeing to subject its decisions on such matters to binding review by an arbitration panel.

II. The line between delegable and non-delegable fiduciary duties is not clear.

Which duties qualify as core management duties and which ones are ministerial is not precisely defined. In *Abercrombie*, for instance, a controlling group of shareholders agreed to bind a portion of the board to an arbitrator's decision if they could not reach a unanimous decision. Chancellor Seitz held this agreement invalid because it did not allow the directors to "handle [all] matters of substantial management policy."[8] Similarly, in *Boston Athletic Association v. International Marathons, Inc.*, 467 N.E.2d 58 (Mass. 1984), the Supreme Judicial Court held invalid a contract entered into by a single corporate officer, which bound the nonprofit, when the contract "totally encumber[ed] the most significant purpose of the [organization]." *Id.* at 63. In the court's view, the board could not delegate to a single officer the power "to bind the corporation to extraordinary commitments or significantly to encumber the principal asset or function of the corporation." *Id.* at 62.[9]

In the same vein, courts have generally prohibited individual directors from engaging in contracts in which they agree to bind themselves to vote a certain way or elect a certain person to the board or hire a certain officer. These principles have long been established. In 1920, the Supreme Court of Minnesota held a contract void when a president of a bank agreed to sell his stock in exchange for being elected chairman of the board of directors. *Van Slyke v. Andrews*, 178 N.W. 959, 960 (Minn. 1920). In *CSFM Corp. v. Elbert & McKee Co.*, 870 F. Supp. 819 (N.D. Ill. 1994), a district court refused to accept defendants' argument that a contract with plaintiff terminated their fiduciary duties, finding that no Wisconsin cases have ever "permitted a corporate officer to modify or amend by contract his/her fiduciary duties to the corporation." *Id.* at 835.

But in other cases, courts have upheld complicated setups that effectively accomplish the same goals. In *Lehrman v. Cohen*, 222 A.2d 800 (Del. 1966), the Delaware Supreme Court upheld an arrangement of stock classes that broke deadlocks between directors. *Id.* at 807 (citing 5 Fletcher Cyclopedia Corporations § 2080 (Perm. ed.)). In *Adams v. Clearance Corp.*, 121 A.2d 302 (Del. 1956), the court did the same. *Id.* at 307–08.

Likewise, in contrast to *Van Slyke* and *CSFM Corp.*, the Southern District of New York has upheld an agreement that, as part of a merger, ensured that several officers would remain in their positions post-merger unless certain procedures were followed. *Woods v. Boston Scientific Corp.*, No. 06 Civ. 5380 (AKH), 2007 WL 754093, at *3 (S.D.N.Y. Feb. 9, 2007). The court found that entering into this agreement, which bound the post-merger board, was not an

[8] *Abercrombie*, 123 A.2d at 898.

[9] *See Clarke Memorial Coll. v. Monaghan Land Co.*, 257 A.2d 234 (Del. Ch. 1969) (prohibiting a board from authorizing two officers to sell substantially all of the corporation's assets on terms that the whole board did not approve); 2 Fletcher Cyclopedia of the Law of Corporations § 495 (2014) ("[T]he directors of the corporation do not have the power to delegate to others those duties that are at the focal point of the management of the corporation.").

"abdicat[ion] [of] authority, but instead [an] exercise[] [of] its business judgment." *Id.* at *4. Somewhat similarly, courts have upheld "best efforts" clauses under which a board agrees to make "reasonable, diligent, and good faith effort[s] to accomplish a given objective." *Great W. Producers Co-Op. v. Great W. United Corp.*, 613 P.2d 873, 878 (Colo. 1980) (en banc).[10] Finally, as part of merger negotiations, a court has upheld a board's agreement to abide by a third-party's valuation as an informed business judgment. *Rosenblatt*, 493 A.2d at 943.

Simply put, there is no clear predictability to the courts' treatment of any single agreement. Issues of strategic plans, operations, budget, and corporate separations (such as the separation of the PTI), however, lie at the heart of the essential functions of managing the affairs of the corporation. While a board may delegate formation of strategic and operating plans and budgets and implementation of major structural changes (such as separation of the PTI) to executive officers and employees, the board retains the obligation to provide oversight of these matters and each director continues to have fiduciary obligations regarding such matters. Any effort to delegate away board oversight obligations to a third party, for example by subjecting board decisions in these areas to binding arbitration raises significant risk that such an agreement would be struck down.

While the dividing line between permissible and unacceptable divestment of responsibility is not clear, the California Corporations Code provides the ability to provide members (including a sole member) with some of the powers that are otherwise reserved to the board, and this suggests that in a corporation with one or more members there is more leeway to provide for binding arbitration relating to board decisions in areas where the member or members have been given certain decision rights

[10] *See also ConAgra, Inc. v. Cargill, Inc.*, 382 N.W.2d 576, 587 (Neb. 1986) (same).