

**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: Governance Chart

DATE: April 17, 2015

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**Overview**

As requested, we have revised the comparison chart, provided to us earlier this week by Robin Gross and Greg Shatan, which describes where certain rights are created and how they are exercised and enforced within the designator and membership models of governance that are under consideration for ICANN. Our revision is attached as Annex A (the “Revised Governance Chart”).

In this memo, we pose several questions for which we respectfully request a response at your earliest convenience. Your answers to these questions will help us to ensure that our work is fully responsive to your needs as you consider how to enhance ICANN’s accountability.

Also in this memo, we provide additional high level background related to implementation of the membership or designator structures.

**Qualifications**

Please note that our legal analysis is based on our understanding of the facts and the goals and priorities of CCWG, and is provided on a general level in keeping with the level of the discussions to date. Our legal analysis is provided for the benefit of the Legal Sub-team and CCWG, to assist in consideration of accountability mechanisms for ICANN and should not be relied upon by any other persons or for any other purpose. These draft responses reflect Sidley’s and Adler & Colvin’s preliminary reactions regarding the Governance Chart and have not been reviewed by any outside third parties. Unless otherwise stated, the legal analysis contained below is based on California law, and in particular, the laws governing California nonprofit corporations (*California Corporations Code, Title 1, Division 2*). In our effort to respond in a very limited time frame, we have not completely and fully explored and researched all of the potential options and nuances posed by the Governance Chart. Also, please note that where we

were uncertain as to underlying concerns reflected in the Governance Chart, we have made certain assumptions or inserted clarifying questions and comments.

### **Key Questions Related to CCWG's Goals**

In calls, chats, and emails over the past week, we've sensed some concerns by some participants in considering the legal advice we've provided regarding available accountability mechanisms and powers. We respect the remarkable and unique community ICANN represents, and our appreciation only grows as we continue to learn more about its inner workings. The existing organization represents a huge investment of volunteer time over many years, and the present effort to increase accountability within ICANN is impressive. In this spirit, we wanted to pose several questions aimed at enhancing our understanding of your goals. Your answers will help ensure that our legal advice is responsive to your needs.

- 1) There has been much discussion of how to create binding accountability mechanisms. To be binding, an accountability mechanism must be enforceable—ultimately through a judicial process—if the parties do not act as the mechanism contemplates. Yet we sense some discomfort with reliance on judicial enforcement mechanisms among the ICANN multi-stakeholder community. We note that the bodies, relationships, and processes provided for in ICANN's bylaws have existed for many years now and have basically worked without significant reliance on external enforcement mechanisms. How important is it for the accountability mechanisms to be binding (enforceable in court if necessary) versus reliant on voluntary compliance as in the current system? Would a non-judicial yet binding enforcement mechanism be a good option, perhaps after exhaustion of the existing mechanisms?
- 2) We have read and heard ongoing debate on the question of exactly what rights (in addition to rights to amend bylaws and select and remove directors and recall the board) the community is seeking over Board decisions— whether it is the power to:
  - a) force the Board to reconsider its decisions while leaving the final decision to the Board, or
  - b) block Board decisions (approval and veto rights), or
  - c) affirmatively force an action (which is really the reservation of a decision to the community body).

More recently, we heard a suggestion that perhaps pre-approval over budget and strategy would be workable. The key advantage to the membership form is the ability to reserve powers to the members (i.e., the community) to approve or reject certain Board decisions. The recommendation in our presentation assumed that was essential. If the community does not need that power—if the ability to ask the Board to reconsider its decisions is sufficient—then a designator structure would perhaps be preferable. Greater clarity may emerge from ongoing WP-1 discussions shortly, but answering this fundamental question is vital to selection of the appropriate form of organizational form.

- 3) Assuming that there is some need for a power to overrule the Board with respect to certain decisions (for example, rejection of or a failure to take action on IRP recommendations), over which decisions does the community need to be able to bind or overrule the Board? The templates lead us to conclude that binding the Board was contemplated in at least some of them, but from the discussions, we have heard conflicting views. Again, should this power to bind the Board go as far as being able to enforce the community preference in court, or will reliance on the Board's voluntary compliance with an arbitral ruling suffice? Please clarify.
- 4) If, using a membership model, members could have the power to bind the Board on budgets or strategic plans, but under a designator model, designators could only force the Board to reconsider its budget or strategic plan (subject to designators' coercive power to remove the Board, but without being able to force their will on the Board), which is preferable?
- 5) We have heard many comments expressing concern over lawsuits by or against designators and members if they are established as unincorporated associations with separate legal personhood from ICANN. We would like to understand better this concern, as we don't see these associations as fundamentally changing the exposure or risk of litigation. On the contrary, the proper use of an unincorporated association provides further protection against an individual participant being sued.

We are continuing to work on the numerous questions that have already been submitted. Having answers to the questions above will improve the quality of our responses, so any guidance which can be provided would be helpful.

Finally, we understand the CCWG will be exposing a draft of its recommendations for public comment toward the end of April. We are unclear what role you see legal counsel playing in the production of that draft, but we hope you plan to give us the opportunity to review it, as we believe we can add value to the end product.

We look forward to what further guidance you can provide, and to helping the CCWG deliver on its obligations to the community.

### **Complexity in Membership and Designator Structures**

Recently questions have arisen regarding the relative complexity of membership and designator structures for ICANN's governance. We believe that membership and designator structures have a roughly similar degree of complexity, but they are complex in different ways, and this difference may have a bearing on the decision the community ultimately makes.

With a membership structure, ICANN would face the complex array of member rights and protections provided by California law, such as the right of members to vote on certain core corporate decisions (e.g., merger, the introduction of new member classes), as well as the requirements for valid member meetings, due-process protections for member terminations, and so forth. Someone at ICANN would need to become familiar with these rights and protections to ensure they are observed; to this end, we recommend incorporating these statutory obligations into the ICANN bylaws, which will of course add to their length. Some of these complexities

may be mitigated by ICANN's unique structure. For example, if each SO occupies its own single-member class (with each class electing and removing its own set of directors, and the members), the statutory requirements for valid member meetings, with notice to be provided a specific number of days in advance, and so forth, become less significant. But this array of rights and protections will still be a significant source of complexity if ICANN adopts a membership structure.

A designator structure involves far fewer statutory rights: basically, these are limited to (i) the right to designate one or more directors; (ii) the right to remove, or veto the removal of, a director without cause; and (iii) if provided in the articles/bylaws, the right to veto amendments to articles and bylaws.

That said, for a designator system to replicate certain features that are available by statute in the member context, we would need to tailor-design bylaws and contractual structures to address designator rights if the board does not follow the bylaws, or to enable reconsideration of a matter by the board. The time and effort for this work, and the complexity of the resulting contracts and bylaws language, could be substantial, perhaps no less so than it would be for members. This would be new territory: We are not aware of a California nonprofit public benefit corporation where special designator rights have been implemented by contract in this way. So, while a designator structure would avoid the statutory complexity of a membership model, ICANN would still need to grapple with potentially very complicated contractual arrangements and bylaws amendments.

**ANNEX A**

**REVISED GOVERNANCE CHART**

[Attached]

<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?
<b>1. Full Board Recall</b>					
<p><b>Right set forth in bylaws and backed by statute:</b> Designator can remove its own designated director(s) at any time for any reason; designator's consent is required before <i>board</i> can remove a designated director <i>without cause</i>.</p> <p><b>PLUS</b></p> <p>A <b>contract</b> among designators is also required, in order to coordinate designator removal action and effect a recall of the entire board.</p> <p><b>GENERAL COMMENTS:</b></p> <p><i>Wherever the rights of designators are established (or augmented) by contract, the designators MUST be legal persons (e.g., either individuals or organized as unincorporated associations). Otherwise there is no ability to enter into a contract and thus no standing to enforce contractual rights in court.</i></p> <p><i>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.</i></p> <p><i>There are two types of director removal in California. One is removal "for cause" and one is</i></p>	<p>(1) The <b>bylaws</b> 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 <b>triggering event</b>.</p> <p>(2) The <b>contract</b> among the designators specifies that, whenever this <i>triggering event</i> happens, each designator is required to remove its designated directors on the board.</p> <p>(3) Each designator then removes its directors pursuant to its <b>bylaw/statutory rights</b>, and the total board is recalled.</p>	<p>(1) The <b>contract</b> 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.</p> <p>(2) If the board refuses to acknowledge the designators' action to remove them as <b>a matter of corporate law</b>—e.g., the directors simply ignore the removal and continue to act as the board—the <i>replacement directors</i> 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.)</p>	<p><b>Right set forth in bylaws and backed by statute:</b> Each member class [1], and only that member class, can remove its own elected director(s) at any time without cause.</p> <p><b>PLUS</b></p> <p>A <b>contract</b> among member classes is also required (or see General Comment below regarding voting agreements) in order to coordinate member-class removal action and effect a recall of the entire board.</p> <p><b>GENERAL COMMENTS:</b></p> <ul style="list-style-type: none"> <li><i>Members must be legal persons (individuals, entities or unincorporated associations). This is a statutory requirement.</i></li> <li><i>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.</i></li> </ul> <p>Note [1]: In a more traditional membership corporation, a general membership would vote</p>	<p>Same mechanism as for designators, if a contract is used to manage the process around full board recall.</p> <p>All the 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 vote for removal/no-confidence reached a specified high threshold, that would trigger the contractual obligation for each member (acting as its own member class) to remove its own directors.</p>	<p>Same as for designators with respect to the members' rights under the inter-member contract.</p> <p>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.</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?
<b>1. Full Board Recall</b>					
<i>"without cause". A board can actually remove ANY director, regardless of how appointed, "for cause", which has a fairly limited meaning (e.g., the director has committed a felony). It is the "without cause" (for any reason) removals that are the focus of our responses.</i>			to elect the general board. With the proposed ICANN structure, each group with the power to put directors on the board would most likely be organized as a member in its own member class. In that way, each SO, etc., would elect its own directors to the board.		

<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?
<b>2. Individual Director Recall</b>					
<p><b>Right set forth in bylaws and backed by statute:</b> Each designator can remove its own designated director(s) at any time for any reason; designator's consent is required before <i>board</i> can remove a designated director <i>without cause</i>.</p>	<p>At designator's discretion or as required under a contract, such as the one described under "Total Board Recall"</p>	<p>If the board or the director in question refused to acknowledge a designator's removal action—e.g., the removed director simply continued to attend board meetings and act like a director, with the board's acquiescence—the <i>replacement director</i> newly named by the designators could bring suit to enforce his/her own appointment. (It is possible that the designator itself may be able to bring this sort of suit, but further research is needed.)</p>	<p><b>Right set forth in bylaws and backed by statute:</b> Each member class,* and only that member class, can remove its own elected director(s) at any time <i>without cause</i>.</p> <p><i>GENERAL COMMENT:</i></p> <p><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></p> <p>* See Note [1] above.</p>	<p>At the member class's discretion or as required under a contract, such as the one described under "Total Board Recall"</p>	<p>Members can enforce their corporate-law statutory rights (1) individually by bringing suit for a failure by the board to acknowledge director removals or new appointments in accordance with bylaws and statute; and (2) on behalf of the corporation against the board where directors have breached their fiduciary duty 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>



<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?
<b>3. Approve Regular Amendments to the Articles or Bylaws</b>					
<p><b>Right set forth in articles and bylaws and backed by statute:</b> Corporate law provides that non-member third parties such as designators may be given the right to consent to certain or all amendments to the articles of incorporation or bylaws.</p> <p>The consent 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><i>GENERAL COMMENT:</i></p> <p><i>Note that designators and other non-member third parties have at most the right to veto proposed amendments under corporate law. This is different from the situation with members and bylaw amendments: members themselves can originate and adopt bylaw amendments even without board consent. (Board consent is still needed for amendments to the articles of incorporation, however.)</i></p>	<p>Whenever the board proposes and adopts an amendment to the articles or specified (or any) bylaws, the prescribed number of designators must consent to the amendment in writing; the change is not effective until that number of consents has been received.</p>	<p>(1) <b>Articles:</b> If the requisite consents 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) <b>Bylaws:</b> 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><b>Otherwise, rights would need to be enforced under contract law (either through a separate contract or by arguing that bylaws were a contract).</b></p>	<p><b>Right set forth in articles and bylaws and backed by statute:</b> 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 consent could be set higher than the threshold required by law (i.e., majority threshold).</p>	<p>(1) <b>Board-initiated amendments:</b> 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>(2) <b>Member-initiated amendments:</b></p> <p>(a) <b>Articles:</b> The members can initiate and approve amendments, which then also require board approval in order for the amendment to be filed with the Secretary of State to be legally effective. Both member and board approval are required.</p> <p>(b) <b>Bylaws:</b> The members can initiate and adopt amendments themselves without board input or approval.</p>	<p>(1) <b>Articles:</b> 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) <b>Bylaws:</b> 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>

<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?
<b>4. Approve Changes to “Golden” Bylaws or Articles Provisions</b>					
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**

*OPTION 1:* Reconsideration right (forcing re-vote with a higher voting threshold of board members)

Procedures for a designator **reconsideration** right could be stated in the **bylaws**. However, it is unclear whether a **board supermajority** to re-approve the strategic plan could be triggered by the reconsideration process.

Alternatively, the bylaws could establish a process in which approval of the strategic plan generally requires a supermajority board vote, unless the strategic plan has been submitted to and approved by the designators previously, in which case the ordinary majority board voting requirement could apply.

This right would not be enforceable under statutory law, which does not provide for giving reserved powers of this sort to non-member third-parties like designators.

The procedure might be enforceable under a **contract**. We need to give further thought to the details of such a contractual arrangement, which might be very complex. (Issues include: who is the counterparty to the designators; what legal consideration is exchanged to make the contract valid; what are the potential remedies for breach,

Reconsideration rights would be exercised by designators pursuant to procedures described in bylaws and, if used, prescribed in a legally enforceable contract.

*GENERAL COMMENT*

**Process:** *Bylaws cannot provide a process that deprives the board of its power and obligation to conduct corporate affairs.*

**Substance:** *Each individual director always retains his/her 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 compel the board to act in a manner contrary to these duties, or reserve approval rights over board decisions, and neither the bylaws (nor any contract) can require that the board abdicate those responsibilities.*

*In addition, unless "strategic plan" is well-defined, the power to disrupt board decisions (whether by designators or*

If the board refused to follow the reconsideration procedures specified in the **bylaws**, then internal escalation could be pursued, and external dispute resolution (e.g. arbitration) mechanisms could be developed to ensure that the procedures are respected. (It is possible that the designators may be able to bring suit in a court of law, but further research would be required regarding standing, and this would need to be aligned with the arbitration provisions.)

If the board refused to follow the reconsideration procedures specified in a **contract**, then both internal and external escalation procedures could be specified in the contract, and would be applicable to the parties to the contract. The contractual remedy arrangement, however, may be very complex.

If the board refused to follow the substantive demands of the designators, then external escalation procedures could be specified in the bylaws (or perhaps in contract), but subject to the board's ultimate decision-making authority.

Escalation to external arbitration might be permitted under the bylaws (or under contract), but the standard of review would have to be so high that it did not impinge on the directors' fiduciary duties, e.g. an abuse of discretion, or a member-like claim that the Board breached its duties or statutory responsibilities. The designators also would have to establish standing to bring suit.

Director removal rights under the bylaws, or full board recall rights under contract,

*OPTION 1:* Reconsideration right (forcing re-vote with a higher voting threshold of board members)

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.

Approval rights over the plan may also be reserved to members in the bylaws.

*OPTION 2:* Right to revisit board decisions by larger community board in 2-tier board

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.

Exercised by the members pursuant to the procedures described in the bylaws.

The bylaws can permit procedures that provide for reconsideration rights or approval rights by the members.

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.

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.

Members further 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.

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.

<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?
<b>5. Approve Strategic Plan</b>					
<p>damages, etc.)</p> <p><i>OPTION 2:</i> Right to revisit board decisions by larger community board in 2-tier board</p> <p>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.</p>	<p><i>members) seems amorphous.</i></p>	<p>could be exercised by designators without resorting to escalation.</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?
<b>6. Approve Budget</b>					
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."