

**MEMORANDUM**

TO: Cross Community Working Group to Develop an IANA Stewardship Transition Proposal on Naming Related Functions (“CWG”)

FROM: Sidley Austin LLP (“Sidley”)

RE: Post-Transition IANA Board “Stress Tests”

DATE: May 13, 2015

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**Overview and Qualifications**

To assist with CWG’s consideration of the role and composition of the board of the Post-Transition IANA (“PTI”), you have asked Sidley to provide stress test scenarios illuminating how the composition of the PTI board might affect certain potential post-transition scenarios. In this memorandum, we discuss how an “insider board” might function under various circumstances, and then compare this to how an “outsider board” might function.

- By “insider board,” we mean a PTI board comprised of a majority of directors who are employed by ICANN, including members of ICANN management responsible for oversight of the IANA functions. These persons would be appointed to the PTI board by ICANN, as the sole member of PTI. (One or more outside directors as defined below could also be on the PTI board but constituting less than a majority.)
- By “outsider board,” we mean a PTI board in which a majority of directors are not employees of ICANN. These “outside directors” could be interested stakeholders or could be wholly independent with no ties to ICANN or the ICANN community. The outside directors could be appointed by ICANN as the sole member of PTI, with specific instructions in the ICANN bylaws on how the various board seats should be filled. This decision on appointment of outside directors could be made by ICANN management, the ICANN board or a membership body of ICANN. Alternatively the selection of PTI outside directors could be made by third party designators, for example if PTI were organized as a California non-profit corporation. ***With an outsider board, given that a majority of the PTI directors would not be employed by ICANN, neither the PTI board nor PTI would be controlled by ICANN, and therefore ICANN would not be responsible nor accountable for PTI’s actions.***

We caution at the outset that with an outsider board model for PTI, the key advantages of maintaining PTI as an entity related to ICANN are undermined since ICANN would have no control of PTI, other than those rights reserved to ICANN as the member of PTI. Additional accountability mechanisms would need to be developed to hold PTI accountable to the community since the accountability mechanisms currently under development for ICANN would be largely ineffectual.

Please note that the discussion of the scenarios provided below is preliminary in nature, tailored to the discussions between CWG and Sidley, and provided to help facilitate CWG’s consideration of options with respect to the PTI board. It should not be relied upon by other persons

for other purposes. This draft memorandum reflects our preliminary independent reactions regarding these matters and has not been reviewed by any third parties. In addition, we have focused on scenarios that we believe may potentially arise but there are many other scenarios (including variations on the scenarios below) that could arise in the future that are not directly addressed by this memorandum.

Unless otherwise expressly stated, this memorandum is based on California and Delaware law, and in particular, the laws governing California non-profit corporations (California Corporations Code, Title 1, Division 2) and the laws governing Delaware limited liability companies (Delaware Code, Title 6, Chapter 18).

## 1. Oversight of PTI/IANA Management Team

- (a) *Scenario:* Making hiring and compensation decisions regarding management of the IANA functions team within PTI.

Hiring and compensating management is a core board function. Under both insider board and outsider board models, the PTI board would have the power to hire the senior management of PTI and determine their compensation.

- (i) Under an insider board model, as discussed above, the majority of the PTI board could be comprised of the ICANN senior personnel who are currently responsible for IANA function oversight. These individuals have experience in hiring, monitoring and compensating the current IANA function team and by virtue of their involvement in these decisions can be held accountable should problems arise.
- (ii) Under an outsider board model where ICANN no longer controls the PTI board, as discussed above, the PTI board would need to gain experience with hiring, monitoring and compensating the IANA functions team. However, ICANN could not be held accountable for PTI board decisions related to these matters since it would have no ability to control these decisions. Additional accountability mechanisms would need to be devised to recreate the ability for the community separately to hold PTI accountable for hiring decisions and the level of compensation set by the PTI board.

- (b) *Scenario:* One or more members of IANA functions team is not performing satisfactorily.

Under both the insider board and outsider board models, the PTI board would have authority to hire and terminate the senior management of PTI, and through that power would address any serious underperformance of the IANA functions team.

- (i) Under an insider board model, the PTI board could be comprised of ICANN senior personnel responsible for IANA function oversight. The IANA functions team ultimately reports to these individuals who are therefore also the logical people to assess whether the IANA functions team is not performing and determine whether to terminate. If the PTI board does not sufficiently deal with the matter, the ultimate accountability mechanisms in place at the ICANN board level may be triggered.

- (ii) Under an outsider board model where ICANN no longer controls the PTI board, there are complex issues associated with recreating the ability for the community separately to hold PTI accountable for the performance of the IANA functions.

## 2. Oversight of PTI Budgets

- (a) *Scenario:* Although the ICANN budget will include details with respect to the IANA functions budget, the PTI board will still need to approve the budget for PTI as a fiduciary and statutory matter (unless PTI is a limited liability company).
  - (i) An insider board comprised of ICANN senior personnel responsible for IANA function oversight would likely already be involved within ICANN in working on the budget and therefore well positioned to advocate for IANA, with relevant experience in the ICANN budget process. If the IANA budget is insufficient, the community oversight mechanisms can be used to hold ICANN and, through ICANN's control of the PTI board, PTI accountable for budget matters.
  - (ii) An outsider board with a majority of non-ICANN board members may be similarly effective in advocating with ICANN regarding the IANA budget, especially if ICANN senior personnel with experience in the ICANN budget are involved as minority board members. In addition, ICANN, as the sole member of PTI, could reserve for itself approval of the budget and strategic plan for PTI, much like what has been proposed by CCWG through the accountability process. However implementation failures that rest with the PTI board – for example, inefficient use and prioritization of resources by IANA – will not be subject to the ICANN accountability mechanisms under development since ICANN will not control the PTI board (except to the extent ICANN reserves for itself certain approval rights as the member of PTI).

## 3. Oversight of ICANN-PTI Contract

- (a) *Scenario:* PTI breaches the ICANN-PTI Contract. Who decides how a law suit by ICANN for breach of contract is defended by PTI?
  - (i) This is a false hypothetical in the insider board situation because PTI would be under ICANN's control and therefore is highly unlikely to take intentional actions in breach of the contract. Should an inadvertent breach arise, PTI would have every incentive to remedy the breach or settle the claim, and ICANN through its PTI board representation could cause PTI to settle the dispute to ICANN's satisfaction. Any abuse of ICANN's powers in this regard would be subject to the community accountability mechanisms currently under development by the CCWG.
  - (ii) In the outsider board model there is potential for PTI to breach the ICANN-PTI Contract and for litigation to ensue. Without control over a majority of the PTI board, ICANN's only recourse would be to sue PTI or pursue some method of alternative dispute resolution against PTI or replace the PTI board – if it had retained that right (for example, where that right was not in the hands of third-party designators).

- (b) *Scenario:* ICANN breaches the ICANN-PTI Contract

Under either board model PTI would have the power to bring suit against ICANN for ICANN's breach of the contract.

In the insider board model, the PTI board may be less likely to bring suit against ICANN because the PTI board members will also be employees of ICANN. However, in both the insider board model and outsider board model, if ICANN is in breach of the ICANN-PTI Contract, it is likely that the accountability mechanisms in place at the ICANN board level would come into play since ICANN would be the party behaving improperly and in violation of the contract.

#### 4. **PTI Third Party Law Suits**

- (a) *Scenario:* What is the ability for the PTI board to determine to sue a third party (for example, for breach of contract)?

Under both insider board and outsider board models, the PTI board has the power to determine to sue a third party and both models could work equally well.

- (b) *Scenario:* If a third party sues PTI, what is the ability for the PTI board to determine how such third party suit is defended?

Under both insider board and outsider board models, the PTI board has the power to determine how to defend a third party law suit and both models could work equally well.

#### 5. **Separation of PTI from ICANN**

- (a) *Scenario:* The IANA function review (“IFR”) IFR or Separation Process results in a recommendation for ICANN to divest PTI. How does the community ensure that PTI takes the requisite steps to separate?

If the divestiture were structured as a transfer by ICANN of the membership interest in PTI, then the divestiture could be effected by ICANN without requiring further action by the PTI board. If the divestiture were structured as an asset sale or a merger, then the PTI board would need to approve the separation and the PTI board would need to make this decision consistent with the exercise of its fiduciary duties to PTI.

The CWG proposal contemplates that the separation mechanism will be a fundamental bylaw for ICANN. Under an insider board model, a PTI board that is designated by ICANN and comprised of ICANN employees would be more likely to implement the separation since ICANN's mandate to separate would be clear.

#### 6. **ICANN Fails to Implement Policy Decision at PTI level**

- (a) *Scenario:* The ICANN board agrees with policy directive “in name” only, but fails to cause PTI to implement the new policy. How does the community ensure that such policies are implemented at PTI?

- (i) Under the insider board model, if ICANN is reluctant to implement a policy directive at the PTI/IANA level, then the accountability mechanisms at the ICANN level could be used to ensure proper implementation of policy directives at the PTI level.
- (ii) Under the outsider board model, the PTI board could ensure that policy directives are implemented. However, there is also a risk that the PTI board would take an independent view of the policy decision agreed to at the ICANN level and refuse to implement the directive. To avoid this risk, accountability mechanisms would need to be implemented at the PTI level similar to what is contemplated at the ICANN level.