

**MEMORANDUM**

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

FROM: Sidley Austin LLP (“Sidley”)

RE: Internal Accountability/Hybrid Model for IANA Transition with Two Closely Related Variants – Initial Discussion Draft

DATE: April 4, 2015

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**Overview and Qualifications**

Based on the CWG discussions in Istanbul, you asked that we focus on a combined internal accountability/hybrid model for the IANA transition with two closely related variants: “accountability mechanisms with legal separation” and “accountability mechanisms with functional separation.”

- “Accountability mechanisms with legal separation” contemplates improved accountability mechanisms with the IANA functions organized into a separate legal entity organized as an affiliate (Post Transition IANA or “PTI”) that is “owned” by ICANN (the “Legal Separation Variant”).
- “Accountability mechanisms with functional separation” contemplates identical improved accountability mechanisms with the IANA functions organized to be as separate from ICANN as possible without actual organization of a legal affiliate structure. (the “Functional Separation Variant”).

Both variants of the model assume that key improvements will be made to ICANN accountability along the lines under consideration by the CCWG, including amendments to the ICANN articles and bylaws to provide the multi-stakeholder community with enhanced means to:

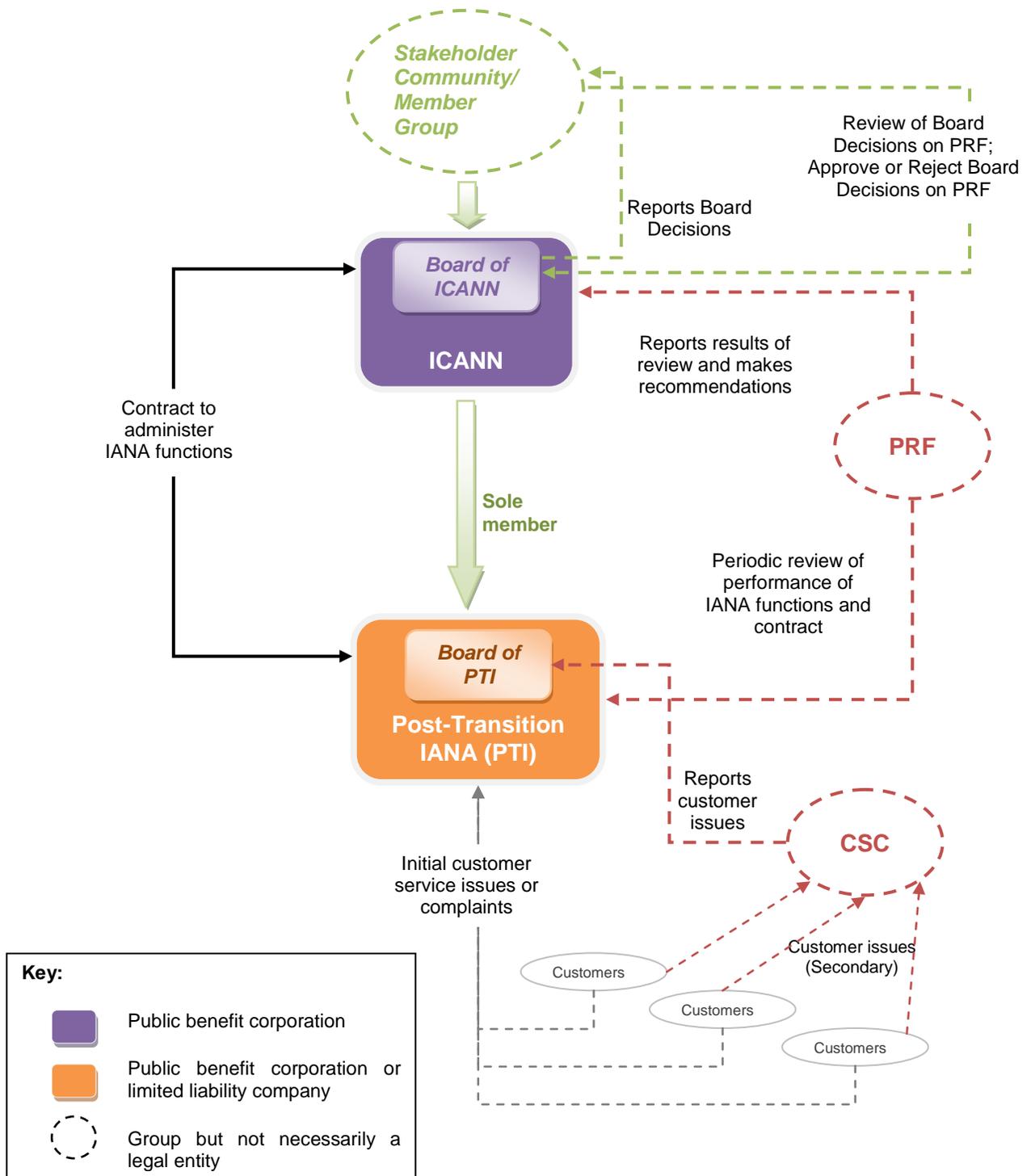
- influence ICANN Board composition, including through potential removal of individual directors and recall of the entire Board;
- limit the ability of the ICANN Board to make unilateral changes to key, “fundamental” bylaws;
- approve certain ICANN Board decisions, for example that relate to budget or key policies or strategies; and
- provide for strengthened independent review and redress.

Given the many similarities between the two variants in the model, the description that follows focuses on the Legal Separation Variant as the base and then identifies how the Functional Separation Variant would differ. This mode of presentation is not intended to reflect a preference for one variant over the other. We have also identified additional considerations for the CWG, potential alternative details and areas that intersect with the CCWG Accountability work stream.

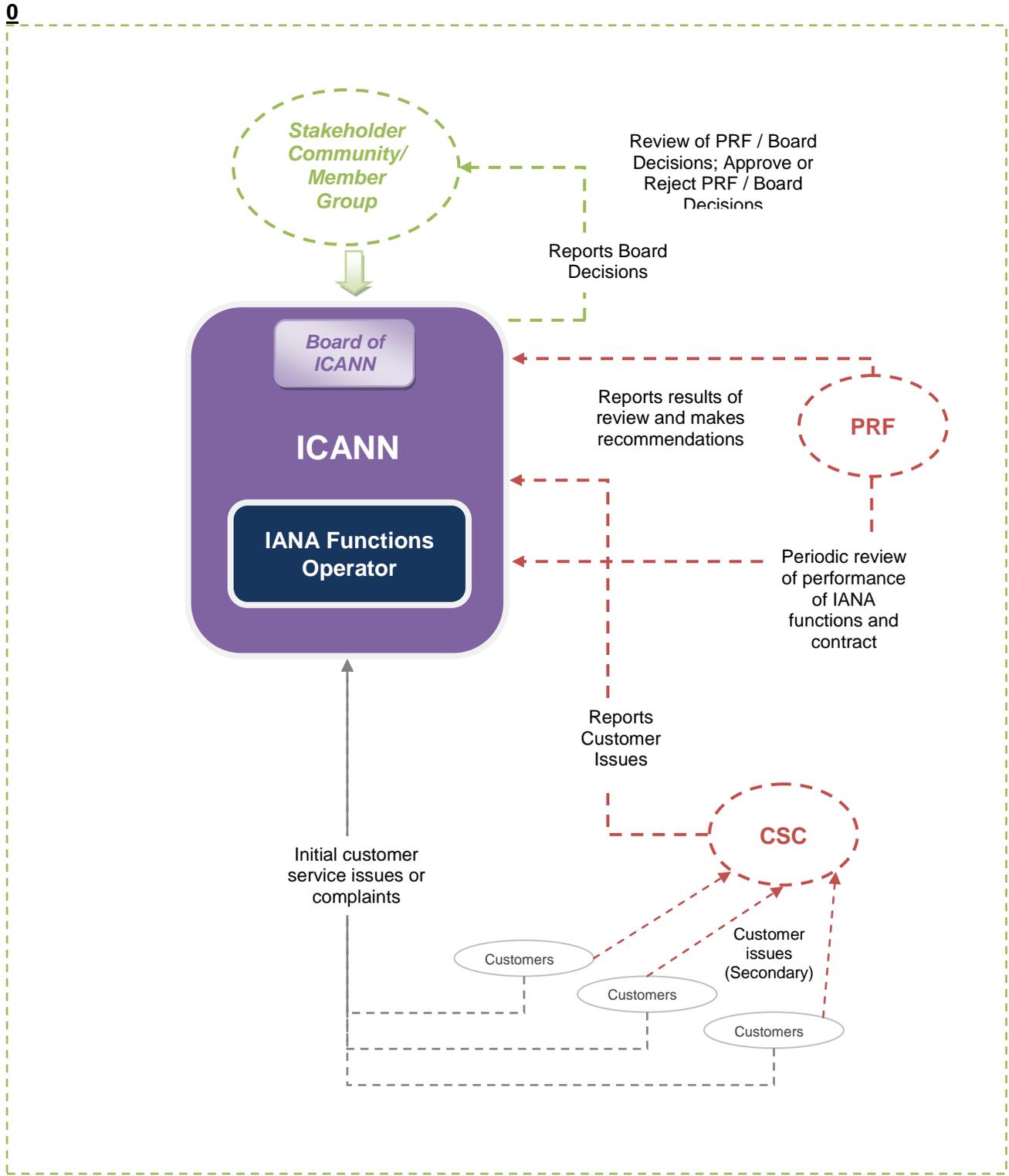
Please note that the draft description of the model provided below is preliminary in nature, tailored to the discussions between the CWG and Sidley, and provided to help facilitate CWG's consideration of the transition options. It should not be relied upon by other persons for other purposes. This draft memorandum reflects our preliminary independent reactions regarding these matters and has not been reviewed by any third parties.

Unless otherwise expressly stated, this memorandum is based on California law, and in particular, the laws governing California non-profit corporations (California Corporations Code, Title 1, Division 2). In our effort to prepare this memorandum under a very short and limited time frame, we have not completely and fully explored and researched all the potential options and implications presented by the two variants of this model.

**INTERNAL ACCOUNTABILITY / HYBRID MODEL: LEGAL SEPARATION VARIANT**



**INTERNAL ACCOUNTABILITY / HYBRID MODEL: FUNCTIONAL SEPARATION**  
**VARIANT**



**I. Description of Proposed “Base” for the Internal Accountability/Hybrid Model (Legal Separation Variant)**

**A. Post-Transition IANA**

1. Post-Transition IANA (“PTI”) would be a “wholly owned subsidiary” of ICANN—in legal terms, more accurately an “affiliate” of ICANN, assuming that PTI is a non-profit corporation without “owners.”
2. ICANN would be the sole member of PTI.
3. The existing IANA naming functions department, administrative staff and related resources, processes, data and know-how would be transferred into PTI (in order to ensure continuity, stability, security and resiliency). This will ensure that the IANA naming functions is functionally and legally “ring fenced” from the ICANN entity.
4. ICANN would assume the current role of the NTIA under the IANA Functions Contract and PTI would assume the current role of ICANN under the IANA Functions Contract. PTI will be the IANA Functions Operator. The issues addressed in the NTIA-ICANN functions contract and related documents will be covered either in the ICANN-PTI contract or by ICANN bylaws and governance documents. Policy making responsibilities will reside within ICANN, with accountability mechanisms that are developed by the CCWG Accountability work stream.
5. PTI could be organized as a public benefit non-profit corporation, as ICANN is, or a limited liability company. See “Additional Considerations and Options” below for a discussion of the pros and cons of these two entity structures.
6. IANA would continue to support RIRs and IETFs under MOUs or other arrangements.
7. ICANN would provide funding and agreed upon resources to PTI through a budget that is approved by the PTI Board, and potentially by the multi-stakeholder community (the “Member Group” as defined below).

**B. PTI Board**

1. The PTI Board could be a parent (ICANN)-designated and controlled board (e.g., a board comprised of ICANN officers or employees) or an independent, multi-stakeholder board.
2. If the PTI Board is an independent, multi-stakeholder board, consideration will need to be given as to who has the power to appoint the PTI Board and the power to remove the PTI Board.

**C. Periodic Review Function**

1. A periodic review team exercising a periodic review function (“PRF”) would be organized for review of the performance of PTI and ICANN with respect to the IANA Functions Contract.
2. The PRF could be organized as an association or as a group. It would not need to be a legal entity, unless the PRF team would need the power to bring lawsuits.
3. The PRF could be convened periodically (e.g., every three years) or it could be a standing group.

4. The PRF must be sufficiently defined to have a meaningful role in periodic review of PTI's IANA functions performance (without being connected to ICANN's policy-making role).
5. After conducting a periodic review, the PRF group would make recommendations to the ICANN Board regarding any necessary changes to the IANA functions. This could include, for example, a recommendation to replace management or the board of the PTI or to terminate or initiate an RFP for the IANA Functions Contract.
6. Upon receipt of PRF recommendations, the ICANN Board would review and either adopt, modify or reject those recommendations. The process for the ICANN Board review of the PRF recommendations would be articulated in the bylaws. These bylaws could be "fundamental bylaws" (i.e., subject to a high threshold for amendment) or require third party approval to amend. This would need to integrate with the CCWG Accountability work stream.
7. If the ICANN Board does not adopt the PRF recommendations—in other words, if it modifies or rejects those recommendations—a mechanism would be in place through the ICANN articles or bylaws to provide for a vote by the Member Group to approve or disapprove the ICANN Board's decision.
  - (a) If rejected, the ICANN Board would have to reconsider its response to the PRF recommendations, and submit to a further plan for Member Group approval or disapproval.
  - (b) If the Member Group further disapproves of the ICANN Board decision with respect to PRF findings, a process to recall the ICANN Board could be triggered or an IRP process could be initiated. Both of these mechanisms would need to integrate with the CCWG Accountability work stream.
  - (c) The expectation is that the requirement of the ICANN Board to submit any modifications to or rejections of PRF recommendations to the Member Group would have a deterrent effect and limit the extent to which the ICANN Board would disregard or overrule PRF recommendations.

#### **D. Customer Standing Committee**

1. The Customer Standing Committee ("CSC") would be an independently organized group.
2. The CSC is designed as a forum for the escalation of customer issues. Note however that it is expected that in the first instance, customers would seek to resolve issues directly with PTI and, only if unresolved, take the matter up to the CSC.
3. The CSC would work with PTI to resolve matters and if necessary could escalate customer issues to the PTI Board and then the ICANN Board if such issues cannot be resolved. The CSC will report and make recommendations to the PTI Board and the ICANN Board, on issues arising from customer issues.
4. The CSC design team is making further recommendations on escalation and the dispute resolution process. This work stream will need to integrate with the CCWG Accountability work on IRP.

## **E. Multi-Stakeholder Community Organization**

1. Both variants of this model assume an active role for the multi-stakeholder community, for example, a community that is empowered to:
  - (a) approve or veto certain key ICANN Board decisions;
  - (b) elect or designate members of the ICANN Board;
  - (c) remove members of the ICANN Board; and
  - (d) approve amendments to certain fundamental bylaws.
2. Such powers require legal personhood, as explained in our memo of March 18, 2015. Therefore, to establish this empowered role, consideration will need to be given on how to further organize a legally cognizable “Member Group” that is either itself designated as a legal person or that is made up of legally cognizable persons (for example individuals designated by the various components of the multi-stakeholder body). Both variants of this model assume and are highly dependent on the creation of an empowered Member Group by the CCWG - Accountability work stream.

## **II. Functional Separation Variant: No Separate IANA Legal Entity**

### **A. Overview**

1. Under the Functional Separation Variant there would be no formation of a separate legal entity to house the IANA functions department, staff and responsibilities, although there would be functional separation (e.g., separate personnel, separate budgets, etc.).
2. Separation would largely be effected through an operational division and supported by accountability mechanisms.
3. There would be no contract between ICANN and IANA, since IANA would not be a separate legal entity.
4. Otherwise, the Functional Separation Variant is similar to the Legal Separation Variant.
  - (a) The PRF would conduct periodic reviews of the IANA functions, and would prepare a report for the ICANN Board in the same manner as in the Legal Separation Variant.
  - (b) The CSC would operate in the same manner as in the Legal Separation Variant.
  - (c) The ICANN Board would need the same measures of accountability as in the Legal Separation Variant (perhaps more so, since there will be no legal separation of IANA).

### **B. Advantages of this variant:**

1. Eliminates the formality of having another legal entity.
2. Avoids the need to create another layer of governance and accountability at the IANA level and associated complexity; the focus can be on ICANN governance and accountability.

3. Avoids the initial complexity of having to separate out IANA assets now and the need to address and resolve potential shared assets.
4. Having IANA remain integrated within ICANN may allow for greater operational efficiency and reduced costs.

**C. Disadvantages of this variant:**

1. If there is a future need to separate or divest ICANN of the IANA functions, the work of identifying and segregating assets will need to be done at the time of separation, which may be at a time of dispute and conflict making the separation more challenging.
2. Does not include an independent governance body at the IANA level with the potential to provide more oversight.
3. There would be no formal contract between ICANN and IANA. Other means of establishing expectations regarding performance levels and related terms would need to be identified, which would likely be less formal and less enforceable than through a contractual relationship. Recourse for a “breach” of those terms and conditions would be limited to internal redress mechanisms such as through the PRF and CSC.

**III. Additional Considerations and Options**

**A. Legal Separation Variant: Post-Transition IANA and PTI Board**

1. Determine Legal structure for PTI: LLC or Non-Profit Public Benefit Corporation

(a) Limited Liability Company (“LLC”). This would not be a formally incorporated entity, but is a legally cognizable entity.

- (1) LLCs have greater flexibility in governance. The LLC Operating Agreement is a contract and can be structured with more or less formality, as desired. An LLC can be managed solely by a member, or can have a board of directors (sometimes called a board of managers or management committee to distinguish it from a corporate board), but the duties and authority may be defined in the LLC Operating Agreement.
- (2) The duties of the LLC managers or board of directors can be determined in the LLC Operating Agreement. They are not as proscribed as the duties of the board of directors of a corporation under California law.
- (3) If ICANN is the sole member/owner of the LLC, the LLC will not need to secure its own tax exemption; rather, the LLC’s activities will be treated as tax-exempt to the same extent as if such activities were conducted by ICANN.
- (4) The LLC, however, should not exist as a stand-alone entity. For international law reasons, it is preferable for it always to be the subsidiary of a non-profit corporation, which would make it easier for it to do business and enforce its rights globally, and would also provide a corporate backstop to liability.

(b) Non-Profit Public Benefit Corporation.

- (1) Well recognized, statutorily protected, and internationally recognized.

- (2) Requires a new tax exemption for PTI. Cannot rely on ICANN's tax exempt status.
- (3) Greater formality, and slightly less flexibility in defining the governance structure of PTI.

Note: For both the LLC and the non-profit public benefit corporation, we refer you to our memorandum dated March 18, 2015 for further description and analysis of the advantages and disadvantages of these entities.

2. Determine Governance Structures. The following are some alternative governance structures to be considered:

- (a) ICANN Controlled Governance: If the PTI is an LLC, the LLC could be managed by ICANN as the sole member or by an ICANN-designated manager. If the PTI is a non-profit corporation, the PTI board could be comprised of ICANN designees.
- (b) Joint ICANN/Independent Governance: The articles or bylaws of PTI could require that ICANN, as the sole member of PTI, establish a PTI board that includes one or more "independent" directors—persons not employed by ICANN and who otherwise lack material relations with ICANN that could impact objective judgment about oversight of the IANA functions operations.
- (c) Independent Governance: The Member Group (or different community groups) most concerned with the IANA functions could be given the ability through the articles or bylaws of PTI to designate board members, with enough designated members such that ICANN does not control a majority or does not control any of the board seats. Consideration would need to be given to the role of such an "independent" board, and whether it adds unnecessary complication or serves a substantive purpose. For example, an independent board may help to address concerns regarding separation of ICANN's role in setting policy from the oversight of and the performance of the IANA functions. Providing PTI with an independent board in a manner in which the ICANN Board is not able to substitute its decisions for the decisions of the PTI board will further evidence and support true separation of the IANA functions from ICANN in the internal accountability / hybrid model.

**B. Periodic Review Function ("PRF")**

1. Composition of PRF.

- (a) How should PRF be selected?
  - (1) Committee of ICANN Board or PTI Board to review performance and address community concerns with respect to the IANA Functions Contract?
  - (2) Committee of stakeholders?

2. Convening the PRF.

- (a) Not a standing committee; will be convened on a periodic basis at the time of a review.
  - (1) Avoids the need to maintain a continuous committee between review cycles; however, consider the loss of institutional knowledge if the committee is only

constituted every three years. This may become a laborious process to select new members and organize, essentially from the ground up, with such lengthy intervals. There may also be the potential for agenda-setting behind the scenes by constituent groups attempting to pre-ordain desired results through their periodic selection of the PRF representatives for each review.

- (b) Alternatively, a standing committee of the PRF could be maintained with a limited mandate between periodic reviews.
  - (1) Annual report could be provided to PRF members to ensure they stay abreast of IANA matters. Substantive review or audit, however, still occurs with less frequency (e.g., 3 years).
  - (2) Members of the PRF could serve longer terms to help ensure institutional knowledge is preserved and maintained.
- (c) The mechanism for Member Group input into the ICANN Board's decisions relating to the PRF could be implemented in a number of ways:
  - (1) The Member Group could recall all or some of the ICANN directors and replace with directors who agree with PRF's recommendations;
  - (2) The Member Group, if statutory members of ICANN, may be provided a veto right over the ICANN Board's decisions; however this must be done in keeping with the general California corporate law principle that the ultimate authority over management of a corporation resides with the board of directors; or
  - (3) A contractual right could be created between ICANN, the corporation and the Member Group or the PRF.

#### **C. CSC**

- 1. Escalation to ICANN Board should only be made under very limited circumstances. Mechanisms should be established to address most issues without needing ICANN Board intervention.
- 2. Membership of CSC and any escalation processes are being addressed by Design Team.

#### **D. Member Group**

- 1. As noted below, these issues will be addressed by the CCWG Accountability work stream but have been included here as they need to be addressed by CCWG in conjunction with the CWG proposal.
- 2. What is the body that holds ultimate accountability over ICANN's stewardship?
  - (a) Members of ICANN?
  - (b) Community Council?
  - (c) Designators of ICANN or PTI directors? This could be a group of "designees" that the Member Group designate.

- (d) Other third party?
- 3. How does it act and what can it do?
  - (a) Approval and veto rights over decisions of ICANN Board?
    - (1) What is the basis for which the Member Group can reject a board decision?
  - (b) Ability to elect directors.
  - (c) Ability to remove directors. In limited circumstances under a high threshold for there to be a vote of no confidence, triggers can be established for when the Member Group could recall the whole board.
  - (d) Trigger separation of ICANN and IANA?
- 4. What is the composition of this Member Group?
  - (a) For example, SOs and ACs could, either as statutory members of ICANN or “designators”, select individuals to exercise the above rights. Note that if the SOs and ACs would themselves be statutory members or designators of ICANN, they would need to form a legally cognizable entity, but this could be a “light weight” unincorporated association.

#### **E. Redress for Failures**

- 1. In the event of any IANA *functional* failure, what happens? Possibilities could include:
  - (a) PTI management could be replaced.
  - (b) PTI Board could be recalled.
  - (c) ICANN Board could be recalled.
  - (d) ICANN could be required to outsource IANA functions to third party.
- 2. In the event that the IANA function is operating properly, but there is a failure at the ICANN level, what happens? Possibilities include:
  - (a) ICANN Board could be recalled.
  - (b) ICANN could be required to divest PTI/IANA Affiliate or IANA division if no legally separate PTI.

#### **F. Third Party Rights**

- 1. Should any rights be reserved for a change in governing documents of ICANN or PTI?
  - (a) Bylaws or LLC agreement cannot be amended without members consent, if there are members.
  - (b) Another third party could be designated to have an approval or veto right.
- 2. What is the requisite majority for an amendment of bylaws or LLC agreement?

3. Arbitration? Could an arbitrator compel the board to take certain actions? Issues arise here as to fiduciary obligations of the person/body doing the compelling.

## **G. Bankruptcy**

### 1. Legal Separation Variant:

- (a) Assuming PTI is a California non-profit corporation or LLC, what impact would an ICANN bankruptcy have on PTI?

- (1) A parent entity bankruptcy filing does not result in a subsidiary entity also becoming a debtor in a bankruptcy proceeding, regardless of whether the subsidiary is a non-profit corporation or LLC. Thus, a wholly owned subsidiary is not also a “debtor” in bankruptcy unless its governing body specifically determines that it should file for bankruptcy or there is some basis to substantively consolidate the subsidiary with the parent (which is unlikely in this circumstance).

- (b) ICANN’s “interest” in PTI will become part of ICANN’s bankruptcy estate.

- (1) ICANN’s ability to use and dispose of this “interest” will be subject to any applicable restrictions set forth in the Bankruptcy Code.

- (2) If ICANN’s interest in PTI is of value, the value of such interest may be available to satisfy ICANN’s creditors. State law restrictions on such interest, including restrictions on the transfer thereof as is the case of California non-profit corporations, may impact the Bankruptcy Court’s determination of value, including resulting in a finding that the interest is of no value for purposes of distributions to creditors.

- (3) If a third party, or PTI itself, were to attempt to take some action that could impair ICANN’s interest, ICANN or its creditors could seek to enjoin that action.

- (4) Filing of bankruptcy should not cause ICANN to succeed to greater rights in PTI. For example, if ICANN has only a bare legal interest, but no equitable interest in the IANA non-profit, the filing of a bankruptcy would not expand this interest.

- (c) Impact on the contract between PTI and ICANN.

- (1) Debtors in bankruptcy are vested with significant rights with respect to contracts, including to (i) assume the contract, (ii) assume and assign their rights under contracts to third parties and (iii) reject the contract.

- (2) There are important restrictions on these rights, however, in certain contexts, including for certain types intellectual property licenses and personal services agreements.

- (3) ICANN’s contracts will also be subject to the provisions of the Bankruptcy Code.

### 2. Functional Separation Variant:

- (a) If the ICANN and IANA functions are consolidated into a single legal entity and the organization were to seek bankruptcy relief, the entire organization (including all assets, liabilities, contracts, and employment relationships) would be subject to the

bankruptcy proceeding and the Bankruptcy Code's legal rules and requirements. In contrast, isolating assets and/or functions in separate legal entities may improve the bankruptcy "remoteness" of each particular entity (and, thus, each entity's assets and functions). As separate legal entities, the parties could impose various restrictions in each entity's by-laws or governing documents that could be impractical or cumbersome if the functions are consolidated in a single legal entity. For example, as a separate legal entity, PTI could be (i) restricted from incurring liabilities other than specific types of liabilities, (ii) limited in terms of its purpose and activities, (iii) prohibited from consolidating or combining with another entity, selling its assets, liquidating or winding up, (iv) restricted from commencing a bankruptcy proceeding, or (v) required to obtain the votes of certain key stakeholder representative members/directors in order to commence such a proceeding. Indeed, these same categories of restrictions, custom-tailored in terms of scope and requirements, could be imposed on the ICANN entity, which would thus maximize the bankruptcy "remoteness" of each individual entity. If the functions are consolidated, the parties essentially lose the benefit of "ring fencing" assets and functions, as described above.

#### **H. Fundamental Bylaws**

1. What will these be? While this is primarily an issue for CCWG, consideration should be given by CWG to whether there are any bylaw matters upon which the model is conditioned.
2. What will be required to amend these bylaws?

#### **I. Independent Review Panel**

1. Where implemented and how? As noted below, this is being considered by the CCWG Accountability work stream.

#### **J. Antitrust**

1. Consider if there are any issues with CSC, PRF and Member Group, but we suggest deferring further antitrust analysis, beyond what already has been provided, until we are closer to a more settled, agreed transition model.

### **IV. Points for Integration with CCWG Accountability Work Stream**

- A. Both the Legal Separation variant and the Functional Separation Variant of this model are dependent on the CCWG Accountability work stream. Specifically, the areas of dependency and need for integration between CWG and CCWG include:
  1. A structure for creating the empowered Member Group and involvement of the Member Group. This includes how the Member Group is composed and what powers it will have, such as the power to:
    - (a) Influence board composition, including through potential removal of individual directors and recall of the entire board;
    - (b) Limit the ability of the board to make unilateral changes to key, "fundamental" bylaws;

- (c) Approve certain board decisions, for example that relate to budget or key policies or strategies or the PRF assessment; and
- 2. An accountability mechanism for reviewing ICANN's policy-making decisions related to the IANA functions.
- 3. Independent review panel for certain matters, including CSC escalation and potentially, disputes between ICANN and PTI on the IANA Functions Contract or disputes between the Member Group and ICANN.